

**BEFORE THE NATIONAL COMPANY LAW TRIBUNAL
HYDERABAD BENCH AT HYDERABAD**

CP No. 22/140/HDB/2016

Date of Order: 20.03.2017

Between:

1. SPC & Associates

Chartered Accountants

Plot No. 252A, Lotus Pond Road, MLA Colony

Road No.12, Banjara Hills

Hyderabad – 500034

... Petitioner

AND

1. DVAK & Co

D.No.1-98/A/K, Flat No. 201,

Plot No. 8 & 9,

Kruthika Layout, Madhapur

Hyderabad – 500081

2. DVA Products and Services

Plot No.95/1, Phase 2, IDA Cherlapally

Hyderabad – 500051

... Respondents

Counsel for the Petitioner:

Sh. A. Nagaraj Kumar

Counsel for Respondent No.1:

Sh. S. Chidambaram, PCS

Counsel for Respondent No.2 :

Sh. P. Jagannatham

CORAM:

Hon'ble Mr. Ravikumar Duraisamy, Member (Technical)

Hon'ble Mr. Rajeswara Rao Vittalana, Member (Judicial)



CERTIFIED TO BE TRUE COPY
OF THE ORIGINAL

ORDER

(As per Ravikumar Duraisamy, Member (T))

1. The present Petition is filed by SPC & Associates (Petitioner herein) under Section 140 of the Companies Act, 2013 read with Rule 78 of the National Company Law Tribunal Rules, 2016, seeking interalia following reliefs:
 - a. Declare that the removal of Petitioner firm as auditor of Respondent No.2 Company as illegal;
 - b. Declare that the appointment of Respondent No.1 firm as auditor of Respondent No.2 Company as illegal;
 - c. Direct the Respondent No.2 to change its auditors under Section 140(5) of the Companies Act, 2013;
 - d. Declare the Petitioner firm as Auditor of Respondent No.2 Company; etc.
2. The present application is filed against the illegal removal of Petitioner, who was originally appointed as auditor of Respondent No.2 Company under Section 139 of the Companies Act, 2013 by Respondent No.2, in collusion with Respondent no.1 and in gross violation of Section 140 and 134 of the Companies Act, 2013 and prevailing rules thereunder.
3. The brief facts of the case as averred in the petition are as follows:
 - a. Respondent No.2 Company was originally incorporated under the Companies Act, 1956 on 27.02.2013 with Registration No.085942 (CIN U93030TG2013NPL085942).
 - b. The main objects of the R2 Company is to develop, promote arts and science by creating infrastructure and other facilities or projects either on its own or by way of lease for conversion of environment, ecosystems, forests, agricultural lands for mutual benefits of members, etc.
 - c. The Respondent No.2 Company originally appointed the Petitioner firm as an auditor of the Company at 3rd Annual General Meeting



held on 18.09.2015 for a period of 5 years starting from the conclusion of 3rd AGM till the conclusion of AGM to be held in 2020 and filed notice of such appointment Form ADT-1 vide SRN S43517713 on 29.11.2015 with the RoC, Hyderabad.

- d. It is submitted that CA Dilli Kumar N and CA Vamsi Krishna Borra are partners of R1 firm, have worked with the Petitioner firm in the capacity of partners for a period of 3 years and quit the Petitioner firm on 31.01.2016. After departing from the Petitioner firm, CA Dilli Kumar N and CA Vamsi Krishna Borra established R1 firm and immediately started soliciting and poaching the clients of Petitioner firm with the acquaintance and relationship developed while working for Petitioner firm.
- e. Ms. Anu Kashyap Durr, one of the Directors of Respondent No.2 Company, in a reply email dated 27.05.2016, to an email forwarded by one of the partners of Petitioner firm dated 27.05.2016, stated that “your proposal to increase the audit fees comes to a complete surprise to us because at the time when we appointed SPCA as our auditors in August, 2014, we had a detailed discussion with Mr.Sesha Prasad and Mr.Vamshi that the audit fee will remain unchanged for a period of 5 years.”

In response to the above email, the Petitioner forwarded a reply substantiating the reasons and responsibilities associated with their professional services that warrant to enhance the audit fees.

- f. Subsequently, on 21.09.2016, Ms Anu Kashyap Durr, sent an email dated 21.09.2016 stating that they have not been satisfied working with the Petitioner firm staff since 01.01.2016 and therefore, finalized on another auditor for all of their companies and requested for resignation letter from the Petitioner firm for all their companies at the earliest.

In reply, the Petitioner firm stated that “Petitioner firm intimated about the implications and repercussions in the light of appointment of R1 Company being in violation of the provisions of the Companies Act, 2013; the institute of Chartered Accountants of



India Act, 1948 and the contractual obligations” and hence not resigned from R2 Company.

- g. It is submitted that R1 firm committed breach of trust, unethical professional practices by misusing the confidential information and taking undue advantage of relationships gained and developed with the clients of Petitioner firm while working for the Petitioner firm, clinchingly proves the malafide intention and wilful default of violating the Section 140 of the Companies Act, 2013 and in collusion and connivance with R2 company, for illegal removal of Petitioner firm as auditor of R2 Company and appointment of R1 firm as auditor of R2 Company, even though seeking NOC from the existing auditors of R2 company.

Some of the material submissions of the Petitioner firm are as follows:

1. No special resolution passed by the R2 Company at the 4th Annual General Meeting of the Company held on 26.09.2016 for the removal of Petitioner firm.
2. R2 Company has not obtained previous approval of the Central Government (Regional Director) for removal of Petitioner firms' existing auditor of R2 company
3. The R2 company has not given any opportunity of being heard to the petitioner firm before removing Petitioner firm as auditor of R2 Company.
4. R2 Company appointing the same staff of Petitioner firm (with whom Ms.Anu Durr was not satisfied since 01.01.2016) i.e. R1 Company as auditors of R2 company for 5 years, clinchingly proves the malafide intention of R2 Company and collusion with R1 Company for illegal removal of Petitioner firm.
- h. Therefore, the present petition is filed seeking the above reliefs before this Tribunal.

5. The petitioner has filed his written submissions dated 27.02.2017 wherein the brief contentions are as follows:



- a. R2 Company appointed the Petitioner firm as an auditor of R2 Company for a period of block of 5 years starting from the conclusion of 3rd AGM held on 18.09.2015 till conclusion of AGM to be held on 2020 of R2 Company.

R2 Company illegally appointed R1 firm as auditor for a period of block of 5 years from the conclusion of 4th AGM held on 26.09.2016 to till the conclusion of AGM to be held on 2021 of R2 Company.

- b. R1's duly signed consent and certificate under Section 141(3)(g) of the Companies Act, 2013 dated 30th August, 2016 to act as Statutory Auditor of R2 company at the forthcoming AGM scheduled on 26th September, 2016 and producing any evidence as to what invited R1 to issue such consent on 30th August, 2016 clinchingly proves the conspiracy between R1 and R2.
- c. R2's Board of Director's statement, "not to ratify the re-appointment of Petitioner and to appoint R1 firm", in Director's report dated 22nd August, 2016 further substantiates R2 intention to illegally remove the Petitioner as auditor of R2 Company without complying with the requisite provisions of the Companies Act, 2013.
- d. R2 company failed to provide the reasons for modification of ordinary resolution for 'ratification of appointment of Petitioner as statutory auditors' at the purported AGM held on 26.09.2016 and replacement of 'appointment' key word with 're-appointment' undoubtedly pro
- e. ves afterthought and fabrication of purported AGM minutes of R2 Company in the form of non-ratification and adjournment of AGM.
- f. Purported appointment of R1 as statutory auditor of R2 Company at its alleged adjourned AGM is in violation of R2 Company's Articles of Association read with Clause 49 (ii) of Table F and therefore such appointment is null and void.
- g. R2 stating that 'R1 is immediately accessible to R2' on 26th September, 2016 denotes conspiracy and put to strict proof and scrutiny.



- h. Explanation II(b) to Rule 6 to the Companies (Audit and Auditors) Rules, 2014 states that – if a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of 5 years.

In the present case, CA Vamsi Krishna signed on behalf of Petitioner the financials of R2 Company for the financial Year 2014-15.

- i. R1 firm is having not even 6 months experience, whereas Petitioner firm is having 27 years of impeccable reputation and experience in audit services.
- j. Petitioner sought 10% minimum increase of remuneration to cover inflation cost and the R2 made baseless allegations as to not happy with the staff of Petitioner (i.e. R1) whom they appointed as auditors. In order to retain self-esteem, the Petitioner has not tendered resignation as against R2 baseless allegations.
- k. The petitioner has also referred to Hon'ble Delhi High Court Judgment in M.S. Kabli Vs Union of India & Ors [W.P.(C) 14341 of 2005 & CM APPL 10758/2005] which held that though Section 224(7) of the Companies Act, 1956 does not indicate the specific grounds on which the removal of the statutory auditors of the company be sought, it has to be for valid reasons.
- l. As per black law dictionary, ratification means – “the confirmation of a previous act done either by the party himself or by another; confirmation of a voidable act.” Further Clause 39 of the Companies (Amendment) Bill, 2016 introduced in Lok Sabha on 15th March, 2016 seeks “to amend Section 139 of the Companies Act, 2013 to do away with the requirements of annual ratification by members with respect to appointment of auditors.”

In addition, if the Companies resort to non-ratify the appointment of auditors instead of removal with due compliance of



statutory provisions, then the entire three tier statutory protection and procedure for removal of auditor will become infructuous.

6. The Respondent No.1 firm submitted their counter dated 16.01.2017 denying various allegations and averment made in the present Company Petition as false, frivolous and vexatious.

- a. It is submitted that the petition filed u/s 140 of the Companies Act, 2013 read with Rule 78 of NCLT Rules, 2016 seeking interim and main/final reference is not maintainable since, Petition under Section 140 of the Companies Act, 2013 arises only if the Company has violated Sections 140 and 134 of the companies Act, 2013 and prevailing Rules. But there is nothing in the petition showing violation of provisions of Section 140 and 134 of the Companies Act and there is nothing shown on record.
- b. It is submitted that various facts have been suppressed in the Petition and the Petitioner has approached the Hon'ble Tribunal with unclean hands and attempted to mislead the Bench by relying upon certain allegations/documents exfacie inadmissible as evidence and further drawing references to the Respondent No.1 who was proposed as Auditor of R2 Company.
- c. That they have never accessed the confidential information and R2 on ascertaining the eligibility and consent of R1 firm, has passed the resolution for the appointment of R2 Company in accordance with the provisions of the Companies Act, 2013.
- d. The shareholders of the R2 Company in their AGM held on 26th September, 2016 have not ratified the appointment of the existing Auditors in terms of proviso to the Section 139(1) of the Companies Act, 2013.
- e. It is not a case of removal of the auditor and that it is a case of non-ratification of the appointment by the Director/shareholders of the Company holding 100% shareholding as per proviso to Section 139 of the Companies Act, 2013.



- f. R1 firm's appointment was made in the vacancy caused by non-ratification as per Rule 3(7) of the Companies (Audit and Auditors) Rules, 2014 and hence, there was no collusion or malafide intention on the part of R1.

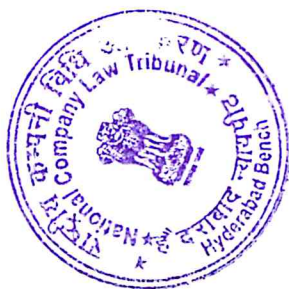
7. Respondent No.2 has also filed a counter dated 16.01.2017 denying the allegations and averments made in the petition on similar grounds as stated in the counter of R1 and also written submissions dated 8.3.2017:

- a. The petitioner admitted that he was insisting for increase of audit fee and the Respondent No.2, much before the AGM, wherein his appointment was not ratified, has clarified that the Audit fee will remain unchanged. Without heading to the response of the R2, he has been persisting for enhancement of fee.

- b. The appointment of Petitioner firm was made in September, 2015 for a period of 5 years subject to ratification at every general meeting. When the shareholders have not ratified his appointment, it means non-confirmation of the previous act thereby making it invalid from the time, the ratification was not done.

Since the appointment of DVAK, Chartered Accountants has not been made in the vacancy created due to by rotation but by non-ratification of the appointment of SPC & Associates by shareholders, the provisions of Rule 6(ii)(b) of the Companies (Audit and Auditors) Rules, 2014 do not apply.

- c. As per ICAI Rules, the new Auditor cannot accept fees lower than what was charged by the predecessor. The revision of the fee was not considered and retained the same fee. The Procedure for obtaining the consent, approval of the Board/Shareholders was followed.
- d. By an act of non-ratification of the auditors, the Petitioner firm's appointment for the year 2016-17 was not confirmed in the AGM and therefore their non-appointment automatically reverts back and deemed to have not been appointed and hence the question of



resorting to removal procedure under Section 140 and all relevant clauses was not required to be followed.

8. Upon perusal of all the materials, submissions made by all the parties, we have observed that the R2 Company appointed the Petitioner for a block of 5 years as Statutory Auditor starting from the conclusion of 3rd AGM held on 18.09.2015 till conclusion of AGM to be held on 2020 of R2 Company. However, Respondent No.2 has in the meanwhile, appointed R1 Company for a period of five years from the 4th AGM till the conclusion of AGM in the year 2021.



9. Both the counsels confirmed that though the Auditor is appointed for a block of five years under section 139 (1) of the Companies Act, 2013, however, their appointment is to be ratified by Members at every AGM. The petitioner has also referred to black law dictionary for the definition of Ratification “the formation of a previous act then either by the party himself or another, confirmation of voidable Act” The Respondent also submitted that the petitioner was not ratified for the apparent reason for increase in audit fee and not happy with the staff of the Petitioner firm. However, the same persons were appointed as the auditor of the Respondent No.2 Company.

10. The Petitioner contended that in the AGM held on 26th September 2016 R.1 was illegally appointed as Statutory Auditor by Respondent No.2 with the consent of R.1 dated 30.08.2016. Further, the petitioner submitted that consent is generally issued only upon its Boards recommendation. The Petitioner also referred to Hon’ble Delhi High Court Order stated supra, and he has referred to Companies (Amendment) Bill 2016 introduced in the Lok Sabha on 15.03.2016 which seeks “to amend Section 139 of the Act to do away with the requirements of the annual ratification by members with respect to appointment of Auditors” The Hon’ble High Court has observed that the provisions of the Companies Act 1956 underscore that statutory auditor cannot lightly be removed and the statutory procedure has to be

followed to the provisions recognized that Auditors are expected to function as independent professionals and not simply toe the line of the management of a company. The Central government will have to be satisfied that the reasons are genuine keeping in view the best interest of the company and consistent with the need to ensure professional autonomy to its auditors. The 3 tier statutory protection is given to Auditors.

11. When analysed the facts of R.1 firm, it is observed that R.1 firm is a new firm with six months of experience. The partners of R1 firm, namely Sri Vamshi Krishna Borra and Sri N. Dilli Kumar were earlier working with Petitioners' firm and started a new firm in the name and style of DVAK & Co whereas the petitioners' firm had an experience of 27 years in the field with impeccable track record and no disciplinary action was taken against the petitioner by ICAI as per the information submitted in the Petition. From the records the reason for non-ratification/removal of the petitioners' firm is apparently due to the fact that the petitioner sought for an increase of 10% of Audit fee.

12. Respondent No.2 also in its communication has stated that as per their understanding audit fee is fixed for a tenure of five years and therefore seeking an increase of 10% is not accepted by R.2 and this was the main reason for the change of auditor/Petitioner. However, R2 Company did not submit any documentary evidence to prove the contentions that audit fee is fixed for a period of 5 years. Moreover, the Bench is of the view that 10% increase in Audit fee sought by the Petitioner is reasonable.

13. For removal of the petitioner U/s 140 (5) (1) a special resolution has to be passed and previous approval of Central Government is required to be obtained. However, as contended by the petitioner in the present case Central Government's approval is not obtained. Even though the Respondent No.2 submitted that the petitioner was not removed but his



appointment was not ratified as per provision under section 139 (1), no justifiable grounds is provided for non-ratification of the petitioner.

14. If the contentions of R2 Company is accepted, there is no guarantee that even R1 Company will be the statutory auditor of the company for a block of 5 years. Further, frequent change of auditor is also not advisable for the effective auditing, preparation of financial statement, transparency in audit policies/procedures, etc. In addition, no plausible/ valid/ genuine reason is apparently made out for non-ratification/removal of Petitioner firm, which would cause grave injury to an established firm with 27 years of experience.

15. Though the Petitioner was not ratified in AGM held on 26.09.2016, Principles of Natural Justice demands that he should have been provided with sufficient opportunity to explain before his non-ratification. Auditor acts as a bridge between management and shareholders of the Company and is an important professional in the whole eco system of the corporate world. Therefore, removal/non-ratification of the Auditor without prior notice/seeking his comments would not be proper.

16. Before getting into the merits/ rival contention of removal/non-ratification of the Petitioner firm, poaching, etc., we are of the prima facie view that the Respondent No.1 firm is not eligible to be appointed as Auditor of R2 Company as per Explanation II(b) to Rule 6 to the Companies (Audit and Auditors) Rules, 2014. Therefore, we admit the present CP No. 22/140/HDB/2016 with following declarations/ directions:

- 1) The removal of petitioner firm as the auditor of R.2 Company and the appointment of R.1 firm as Auditor of R.2 Company is improper.
- 2) We direct the R2 Company to continue the Petitioner firm as the Auditor of R2 Company till the next AGM and subsequently



necessary course of action can be taken by R2 Company regarding the continuation of Petitioner firm, in accordance with law.

- 3) We further direct the R.2 Company to take necessary steps to appoint the petitioners' firm as Auditor of R.2 Company.
 - 4) We direct the R1 firm to submit all the records available in their possession of R2 Company, if any, and to cooperate with the Petitioner firm to conduct the audit of books of accounts of R2 Company.
- No order as to costs.



Sd/-

RAVIKUMAR DURASAMY
MEMBER (T)

Sd/-

RAJESWARA RAO VITTANALA
MEMBER (J)

V. Anna Poorna
V. ANNA POORNA
Asst. DIRECTOR
NCLT, HYDERABAD - 68