Companies Bill 2012

Highlights and analysis

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Foreword

The long awaited Companies Bill, 2012 got its assent in the Lok Sabha on December 18, 2012. An attempt has been made to reduce the content of the substantive portion of the related law in the Bill as compared to the Companies Act, 1956. In the process a lot of the aforesaid content has been left, “to be prescribed”, in the Rules (340+) which are yet to be seen.

In this regard, we are pleased bring to you our new publication – Companies Bill, 2012: Highlights and Analysis. This publication brings out the significant changes proposed by the Bill as compared to the Companies Act, 1956 and our initial analysis thereon. It is pertinent to note that for the complete understanding of the implication of various clauses of the Bill, the related Rules will need to be read with. As on date, these Rules are in the drafting stage and are expected to be put up on the MCA website for public comments in next couple of months.

The Companies Bill, 2012 introduces few significant changes in the provisions related to governance, e-management, compliance and enforcement, disclosure norms, auditors and mergers and acquisition. Also new concepts like One Person Company, small companies, dormant company, class action suits, registered valuers and Corporate Social Responsibility have been included.

We hope that this publication is useful for understanding of the key changes being proposed and their potential implications.

Price Waterhouse
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Introduction

The Companies Bill, 2012, envisages significant changes aimed at greater accountability, additional disclosure norms, investor protection, e-governance, facilitating mergers and acquisitions, corporate social responsibility etc.

The Companies Act, 1956 (the 'Act') has been in need of a substantial revamp for quite some time now, to make the same more contemporary and relevant to the corporates, stakeholders and regulators in India.

While, several unsuccessful attempts have been made in the past to revise the existing Act, there have been quite a few changes in the administrative portion of the Act. The most recent attempt to revise the Act was the Companies Bill, 2009 which was introduced in the Lok Sabha, one of the two Houses of the Parliament of India, on August 3, 2009. This Companies Bill, 2009 was referred to the Parliamentary Standing Committee on Finance, which submitted its report on August 31, 2010 and was withdrawn on the introduction of Companies Bill, 2011. The Companies Bill, 2011 was also considered by the Parliamentary Standing Committee on Finance which submitted its report on June 26, 2012. Subsequently, the Bill was considered and approved by the Lok Sabha on December 18, 2012 as Companies Bill, 2012 (the 'Bill').

The changes proposed in the Bill have far reaching implications and are all set to significantly change the manner in which corporates operate in India. In this publication, we have encapsulated the major changes as compared to the Act and the potential implications of these changes. However, it needs to be mentioned here that there are significant areas for which "rules" are yet to be framed (the Bill currently has approximately 346 places where the phrase 'as may be prescribed' is used).

Companies Bill, 2012: A Statistical Snapshot	
Number of Schedules	7
Number of Chapters	29
Number of Clauses	470

Setting up of a Company

» *Incorporation of a Company*

» *Prospectus and Public Offer*

» *Share capital and debentures*

The Bill introduces a new form of entity "One Person Entity" and incorporates certain new provisions in respect of Memoramdum and Articles of Association. For instance the concept of entrenchment provision has been introduced regarding articles of association.

Incorporation of a Company

1. One Person Company

The Bill introduces a new type of entity to the existing list of companies i.e. apart from forming a public or private limited company, the Bill enables the formation of a new entity 'One Person Company' (OPC) OPC means a company with only one person as its member. [Clause 3(1)]

2. Memorandum of Association

Content: The Bill specifies the mandatory content for Memorandum of Association which is similar to the existing provisions of the Act and refers inter-alia to the following:

- name of the company with last word as limited/private limited as the case may be;
- state in which registered office of the company shall be situated;
- liability of the members of the company etc

However, as against the existing requirement of the Act, the Bill does not require the objects clause in a memorandum to be classified as:

i. the main object of the company;

ii. objects incidental or ancillary to the attainment of the main object; and

iii. other objects of the company.

[Clause 4(1)]

Act/section refers to Companies Act, 1956
Bill/clauses refers to Companies Bill, 2012 (As passed by Lok Sabha)

The basic purpose of the Act for such classification as set out in section 149 of the Act, is to restrict a company from commencing any business to pursue 'other objects of a company' which is not incidental or ancillary to the main objects except to the satisfaction of certain requirements as prescribed in the Act like passing a special resolution, filing of declaration with Registrar to the effect of resolution.

Reservation of name: The Bill incorporates the procedural aspects for applying for availability of name for a new company or an existing company in clause 4(4) and 4(5).

As against the existing requirement of the Act, the Bill states that where after reservation of name, it is found that name was applied by furnishing wrong or incorrect information, then-

- if the company has not been incorporated, the reserved name would be cancelled and the applicant would be liable for penalty which can extend to Rs. 1 lakh
- if the company has been incorporated, the Registrar can either direct the company to change its name within a period of 3 months after passing an ordinary resolution or take action for striking off the name of the company or make a petition for winding up.

3. Articles of Association

The Bill introduces the entrenchment provisions in respect of the Articles of Association of a company. An entrenchment provision enables a company to follow a more restrictive procedure than passing a special resolution for altering a specific clause of articles of association. A private company shall make entrenchment provision only if agreed by all its members or, in case the case of a public company, if a special resolution is passed. [Clause 5]

4. Incorporation of company

The Bill mandates inclusion of declaration to the effect that all the provisions of the Act have been complied with which is in line with the existing requirement of Act.

Additionally, an affidavit from the subscribers to the memorandum and from the first directors to the effect that they are not convicted of any offence in connection with promoting, forming or managing a company or have not been found guilty of any fraud or misfeasance, etc., under the Bill during the last 5 years along with the complete details of name, address of the company, particulars of every subscriber and the persons named as first directors has to be filed with Registrar.

The Bill further prescribes that if a person furnishes false information, he along with the company would be subject to penal provisions as applicable in respect of fraud i.e. clause 447 [Clause 7(4); Also refer chapter on 'Other Areas']

5. Formation of company with charitable objects

An OPC with charitable objects may be incorporated in accordance with the provision of the Bill. New objects like environment protections, education, research, social welfare etc., have been added to existing objects for which a charitable company could be incorporated.

As against the existing provisions under which a company's license could be revoked, the Bill provides that license can be revoked not only where the company contravenes any of the requirements of the clause but also where the affairs of the company are conducted fraudulently or in a manner violative of the objects of the company or prejudicial to the public interest. The Bill thus provides for more stringent provisions for companies incorporated with charitable objects. [Clause 8]

6. Commencement of business, etc

The existing provisions of Act as set out in section 149 which provides for requirement in respect of commencement of business for public companies having share capital would now be applicable to all companies.

The Bill empowers the Registrar of companies to initiate action regarding removal of the name of a company in case the company's directors have not filed the declaration relating to shares agreed to be taken and share capital within 180 days of its incorporation and if the Registrar has reasonable cause to believe that the company is not carrying on business or operations. [Clause 11]

7. Registered office of company

Where a company has changed its name in last two years, a company is required to paint or affix or print its former names along with the new name of the company on business letters, bill heads etc. However, the Bill is silent on the time limit for which the former name needs to be kept. [Clause 12]

8. Alteration of Memorandum

The Bill imposes additional restriction on alteration of object clause of memorandum for a company which had raised money from the public for one or more objects mentioned in the prospectus and has any unutilized money. The Bill specifies that along with obtaining an approval by way of a special resolution, a company would be required to ensure the following if it intends to alter its object clause: [Clause 13]

- publishing the notice of aforesaid resolution stating the justification of variation in two newspapers; and
- exit option be given to the dissenting shareholders by the promoters and shareholders having control in accordance with the regulations to be specified by Securities and Exchange Board of India (SEBI).

9. Subsidiary company not to hold shares in its holding company

The existing provision of section 42 of the Act which prohibits a subsidiary company to hold shares in its holding company continues to get acknowledged in the Bill. Thus, the earlier position that if a subsidiary is a body corporate may hold shares in another body corporate which is the subsidiary's holding company continues to apply. [Clause 19].

10. Service of documents

The Bill recognizes electronic mode in respect of service of documents on the company [Clause 20].

Prospectus and Public Offer

The Bill has introduced a new clause (Clause 23) to explicitly provide the ways in which a public company or private company may issue securities. This clause provides that a public company may issue securities in any of the following manner:

a. to public through prospectus

b. through private placement

c. through rights issue or a bonus issue.

For private companies, this clause provides that it may issue securities through private placement or by way of rights issue or bonus issue.

Clause 23 also provides that compliance with provisions of part I of chapter III is required for issue of securities to public through prospectus. For private placement compliance with the provisions of part II of chapter III of the Bill is required.

The Bill also proposes certain changes with respect to prospectus and public offers which are aimed at enhancing the disclosure requirements as well as streamlining the process of issuance of securities.

1. Issue of prospectus

Currently, the matters/reports to be included in the prospectus are specified in parts I and II of Schedule II of the Act. In the proposed Bill, the information to be included in the prospectus is specified in Clause 26 of the Bill. The Bill proposes certain additional disclosures which include:

- any litigation or legal action pending or taken by a Government Department or a statutory body during the last five years immediately preceding the year of the issue of prospectus against the promoter of the company
- sources of promoter's contribution

The Bill has also relaxed the disclosure requirements in some areas. Examples of certain disclosures which are not included in the Bill are:

- particulars regarding company and other listed companies under the same management which made any capital issues during the last three years.
- export possibilities and export obligations
- details regarding collaboration

The Bill proposes that report by the auditors on the assets and liabilities of business shall not be earlier than 180 days before the issue of the prospectus [Clause 26 (1)(b)(iii)]. The Act currently requires that the report will not be earlier than 120 days before the issue of the prospectus.

2. Variation in terms of contract or objects

The Bill proposes that a special resolution is required to vary the terms of a contract referred to in the prospectus or objects for which the prospectus was issued [Clause 27 (1)]. The Act currently requires approval in general meeting by way of an ordinary resolution. The Bill also requires that dissenting shareholders shall be given an exit offer by promoters or controlling shareholders [Clause 27 (2)].

3. Offer of sale of shares by certain members of the company

The Bill includes a new clause under which members of a company, in consultation with the Board of Directors may offer a part of their holding of shares to the public. The document by which the offer of sale to the public is made will be treated as prospectus issued by the company. The members shall reimburse the company all expenses incurred by it [Clause 28].

4. Advertisement of prospectus

The Bill requires that advertisement of any prospectus shall specify the contents of its Memorandum regarding the objects, the liability of members, amount of share capital of the company, the names of the signatories to the memorandum, number of shares subscribed for by them and its capital structure [Clause 30].

5. Shelf Prospectus

The Bill extends the facility of shelf prospectus by enabling SEBI to prescribe the classes of companies that may file a shelf prospectus. The Act currently limits the facility of shelf prospectus to public financial institutions, public sector banks or scheduled banks [Clause 31 (1)].

6. Global depository receipts (GDRs)

The Bill includes a new clause to enable issue of depository receipts in any foreign country subject to prescribed conditions [Clause 41]. Currently the provisions of Section 81 of the Act relating to further issue of shares are being used in conjunction with the requirements mandated by SEBI for issuance of depository receipts. One of the intention consistent across the provisions of the Bill appears to be the incorporation of requirements which supplement SEBI's powers, wherever there are existing requirements specified by SEBI.

7. Private placement[1]

The Bill requires that certain specified conditions are complied with in order to make an offer or invitation of offer by way of private placement otherwise than through issue of a prospectus. Some of significant conditions are:

a. The offer of securities or invitation to subscribe securities in a financial year shall be made to such number of persons not exceeding fifty or such higher number as may be prescribed (excluding qualified institutional buyers, and employees of the company being offered securities under a scheme of employees stock option in a financial year and on such conditions (including the form and manner of private placement) as may be prescribed. The provision of the Bill is in line with the existing provisions of the Act.

b. The allotments with respect to any earlier offer or invitation have been completed.

c. All monies payable towards subscription of securities shall be paid through cheque or demand draft or other banking channels but not by cash.

d. The offers shall be made only to such persons whose names are recorded by the company prior to the invitation to subscribe, and that such persons shall receive the offer by name.

e. The company offering securities shall not release any advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about such an offer. [Clause 42]

The bill has relaxed disclosure requirements in a prospectus, introduced new clauses on offer of sale of shares by certain members and GDR and extended facility of shelf prospectus. These are welcome step as they reflect efforts to change the laws in accordance with new economic realities.

[1] Private placement means any offer of securities or invitation to subscribe securities to select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies the conditions specified in the respective clause.

Share capital and debentures

The Chapter on Share Capital and Debentures introduces some key changes in the Bill. To illustrate, the Bill does not give any cognizance to existing requirement of section 90 of the Act that provided some saving grace to private companies. Therefore, the applicability of following clauses is no longer restricted to public companies and private companies which are subsidiaries of a public company and are now applicable to private companies also:

a. Two kinds of shares capital

b. New issue of shares capital to be only of two kinds

c. Voting Rights

1. Numbering of shares and Certificate of shares

The existing requirement of section 83 of the Act states that shares held with depository would not be subject to numbering, however, clause 45 of the Bill restrict the same only to the shares held by a person whose name is entered as holder of beneficial interest in such shares in the records of the depository.

Clause 46 of the Bill in respect of certificate of shares states that if shares are held in depository form, the record of the depository would be construed as the prima facie evidence of the interest of the beneficial owner.

2. Voting rights

The provisions of Bill regarding voting rights are similar to the existing section 87 of the Act. The only change noted from the Bill is with regard to the removal of distinction provided by the Act in respect of the entitlement to vote in case a company fails to pay dividend to its cumulative and non-cumulative preference share holders. [Clause 47]

3. Variation of shareholder's rights

Similar to the other provisions of the Act, the Bill acknowledges the requirements of section 106 of the Act with an additional requirement in respect of those classes

The provisions regarding private placement and additional disclosures in prospectus will also help to strengthen the capital markets.

The Bill proposes to re-instate the existing concept of shares with differential voting rights. Pursuant to this clause a company may face hardship with regard to computation of proportionate voting rights.

of share holders whose rights are getting affected pursuant to any variation. The proviso to clause 48(1) states that if variation by one class of shareholders affects the rights of any other class of shareholders, the consent of three-fourths of such other class of shareholders shall also be obtained and the provisions of this section shall apply to such variation.

4. Application of premiums received on issue of shares

The Bill lays down similar requirement in clause 52 as that of the section 78 of the Act in respect of application of premiums received on issue of shares; however, the clause has a non-obstante provision in respect of certain class of companies which would be prescribed at a later date. The Bill states that these classes of companies would not be able to apply the securities premium towards the below specified purposes, unless the financial statements are in compliance with the accounting standards issued under clause 133:

- paying up unissued equity shares of the company as fully paid bonus shares
- writing off the expenses of or the commission paid or discount allowed on any issue of equity shares of the company
- purchase of its own shares or other securities

The Bill restricts the application of securities premium for certain class of companies if they fail to comply with the accounting standards. The Bill continues to state that securities Premium amount can be utilised for purpose of writing off preliminary expenses. However, in lieu of the requirements of Accounting Standard 26, Intangible Asset, the requirement of this sub-clause appears to be superfluous.

5. Prohibition on issue of shares at a discount

Companies would no longer be permitted to issue shares at a discount. The only shares that could be issued at a discount belong to the class of sweat equity wherein shares are issued to employees in lieu of their services. [Clause 53 and Clause 54]

Further, explanations I and II to the existing section 79A of the Act that prescribe the provisions in respect of sweat equity have not be included in the Bill. [Explanation I defined company for the purpose of this section and explanation II defined sweat equity.]

6. Issue and redemption of preference shares

The existing requirements of sections 80 and 80A of the Act in respect of issue and redemption of preference shares continue to be acknowledged by the Bill. The Bill reiterates the existing requirement that a company cannot issue preference shares with a redemption date of beyond 20 years. However, it gives an exemption in cases, where preference shares have been issued in respect of infrastructure projects. Infrastructure projects are specified in Schedule VI of the Bill and these shares would be subject to redemption at such percentage as prescribed on an annual basis at the option of such preference shareholders.

Further, the Bill adds another administrative requirement of obtaining a special resolution in respect of preference shares which could not be redeemed by a company. The Bill states that where a company is not in a position to redeem any preference shares or to pay dividend, if any, on such shares in accordance with the terms of issue, it may, with the consent of the holders of three-fourths in value of such preference shares and with the approval of the Tribunal issue further redeemable preference shares equal to the amount due, including the dividend thereon, in respect of the unredeemed preference shares. On the issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed.

The Bill does not envisage any penalty in respect of compliance with the provision of this clause, as was prescribed in sub-section (6) and (3) of section 80 and 80A of the Act respectively. [Clause 55]

7. Allotment, transfer and transmission of securities

The Bill lays down new timelines in respect of allotment, transfer and transmission of securities [Clause 56]. The revised timelines are as under:

- in the case of subscribers to the memorandum, within a period of 2 months from the date of incorporation;
- in the case of any allotment of any of its shares, within a period of 2 months from the date of allotment;
- within a period of 1 month from the date of receipt of the instrument of transfer of securities;
- within a period of 6 months from the date of allotment of debentures.

8. Refusal of registration and appeal against registration

The provision relating to refusal of registration of transfer or transmission of securities by private and public companies has been separately clarified in the Bill. The private and public companies are required to send the notice of refusal within 30days of the receipt of instrument of transfer, and an aggrieved party may appeal to Tribunal against the refusal within 30 days/60 days/90 days from the date of receipt of notice or non receipt of notice as the case may be. [Clause 58(2)]

9. Further issue of share capital

The existing requirements of section 81 of the Act with regard to further issue of capital would no longer be restricted to public companies and thus applicable to private companies also, as sub-section 3 of section 81 of the Act has not been acknowledged in the Bill.

Further, the Bill provides that a rights issue can also be made to the employees of the company who are under a scheme of employees' stock option, subject to a special resolution and subject to conditions as prescribed. Further, the price of such shares should be determined using the valuation report of a registered valuer, which would be subject to conditions as prescribed. [Clause 62]

10. Issue of bonus shares

The existing Act does not have any specific provision dealing with issue of bonus shares although it has referred to the concept of bonus shares at many places. The Bill includes a new clause that provides for issue of fully paid-up bonus shares out of its free reserves or the securities premium account or the capital redemption reserve account subject to the compliance with certain conditions such as authorization by the articles, approval in the general meeting etc. [Clause 63]

11. Unlimited company to provide for reserve share capital on conversion into limited company

This clause corresponds to section 32 of the Act and seeks to provide that an unlimited company having a share capital may be reregistered as a limited company by increasing the nominal amount of each share, subject to the condition that no part of the increased capital shall be capable of being called up, except in the event and for the purposes of the company being wound up. The Bill further provides that a specified portion of its uncalled share capital shall not be capable of being called up except in the event and for the purposes of a company being wound up.[Clause 65]

12. Reduction of share capital

The Bill gives cognizance to one of the amendments made in the Listing Agreement by Securities and Exchange Board of India. A new clause 24(i) was inserted to the Listing Agreement which provided that a scheme of amalgamation / merger / reconstruction, should comply with the requirements of section 211(3C) of the Act. A similar requirement has been introduced by the Bill in clause 66 which states that no application for reduction of share capital shall be sanctioned by the Tribunal unless the accounting treatment, proposed by the company for such reduction is in conformity with the accounting standards specified in clause 133 or any other provision of the Bill and a certificate to that effect by a company's auditor has been filed with the Tribunal.

Further, the Bill clarifies that no such reduction shall be made if the company is in arrears in the repayment of any deposits accepted by it, either before or after the commencement of the Bill, or the interest payable thereon.

13. Power of company to purchase its own securities

The existing provision of section 77A of the Act have been acknowledged by the Bill. The only identified difference is that the option available to company for buy-back from odd lots is no longer available. [Clause 68]

The Bill appears to have removed the option of multiple buyback of securities as the existing proviso to section 77A(2) has been re-aligned.

Act/section refers to Companies Act, 1956
Bill/clauses refers to Companies Bill, 2012 (As passed by Lok Sabha)

Management and Administration

The proposals in the Bill provide flexibility in the management and administration of companies by recognising electronic mode for issue of notices and voting, which is in line with the MCA's efforts to give cognizance to the use of electronic media as evident from a number of 'green initiatives' introduced recently and maintenance of registers and returns at a place other than the registered office.

The Bill also proposes to improve corporate governance by requiring disclosure of the nature of concern or interest of key managerial personnel and relatives of directors, managers and key managerial personnel and reduction in threshold of disclosure from 20% to 2%.

1. Annual Return

The Bill proposes that the requirement of certification of annual return by a company secretary in practice will be extended to companies having prescribed and paid up capital and turnover [Clause 92(2)]. The Act requires certification only for listed companies.

The level of information required to be included in the annual return has been increased. The additional information required includes particulars of holding, subsidiary and associate companies, remuneration of directors and key managerial personnel and penalty or punishment imposed on the company, its directors or officers [Clause 92(1)].

2. Place of keeping registers and returns

The Bill proposes to allow registers of members, debenture-holders any other security holders or copies of return, to be kept at any other place in India in which more than one-tenth of members reside if approved by a special resolution passed at a general meeting. [Clause 94(1)]. The flexibility in the Act is limited to a place within the city, town or village in which the registered office is situated.

3. General meetings

The Bill proposes that the first annual general meeting should be held within nine months from the date of closing of the first financial year of the Company [Clause 96(1)], whereas the Act requires the first annual general meeting to be held within eighteen months from the date of incorporation.

Currently, the Act does not define business hours, which the Bill now defines as between 9 a.m. and 6 p.m. The Bill proposes that annual general meeting cannot be held on a national holiday[2] whereas the annual general meeting cannot be held on a public holiday[3] as per the existing provisions of section 166(2) of the Act [Clause 96(2)].

[2] National Holiday means and includes a day declared as National Holiday by the Central Government [Explanation to Clause 96 of the Bill]

[3] Public Holiday means a public holiday within the meaning of the Negotiable Instruments Act, 1881 [Section 2(38) of the Act]

In order to call an annual general meeting at shorter notice, the Bill proposes consent of 95% of the members entitled to vote at such meeting [Clause 101(1)]as against the current requirement in the Act which requires consent of all the members.

The Bill recognises that notice of general meeting can be given through electronic mode. [Clause 101(1)] and further also recognises the right to vote by the electronic means. [Clause 108]. This is in line with the green initiatives already put in place by the Ministry of Corporate Affair (MCA, the company)in the recent past of giving cognizance to the use of electronic media in the operations of a company.

The Bill proposes that besides directors and managers, the nature of concern or interest of key managerial personnel and relatives of directors, managers and key managerial personnel in each item of special business will also need to be mentioned in the notice of the meeting [Clause 102 (1)]. Also, the threshold of disclosure of shareholding interest in the company to which the business relates of every promoter, director, manager and key managerial personnel has been reduced from 20% to 2% [Clause 102 (2)].

The Bill proposes that in case of a public company, the quorum will depend on number of members as on the date of meeting. The required quorum is:

- 5 members if number of members is not more than one thousand;
- 15 members if number of members is more than one thousand but upto five thousand;
- 30 members if number of members is more than five thousand [Clause 103 (1)]

A limit has been introduced on the number of members which a proxy can represent. The Bill proposes a limit of 50 members. Besides, the Bill also provides that the limit in terms of number of shares may be prescribed. [Clause 105 (1)]

Further, it is interesting to note that private companies cannot impose restrictions on voting rights of members other than due to unpaid calls or sums or lien. [Clause 106 (1)]

Listed companies will be required to file with the registrar, a report in the prescribed manner on each annual general meeting, including the confirmation that the meeting was convened, held and conducted as per the provisions of the Bill and the relevant rules [Clause 121].

The existing requirement of holding statutory meeting and preparing statutory report has done away with.

4. Other matters

Listed companies will be required to file a return with the Registrar with respect to change in the number of shares held by promoters and top ten shareholders within fifteen days of such change [Clause 93]. This requirement again demonstrates the effort made towards synchronizing the requirements under the Bill with the requirements under SEBI. Additionally, on an annual basis, companies are also currently required to make the disclosures with respect to top shareholders under the Revised Schedule VI to the Act

The Bill requires every company to observe secretarial standards specified by the Institute of Company Secretaries of India with respect to general and board meetings [Clause 118 (10)], which were hitherto not given cognizance under the Act. Additionally, it is also interesting to note that these standards do not have a mandatory status for practicing company secretaries.

Directors

» *General*

» *Meetings of the Board and its powers*

» *Appointment and Remuneration of managerial personnel*

General

1. Woman director

As with certain provisions across the Bill, the category of companies which need to comply with the requirement of having at least of one woman director is yet to be prescribed [Clause 149(1)]. While this new requirement will go a long way in encouraging gender diversity, it has already created quite a stir in terms of the manner in which companies will ensure compliance.

2. Number of directorship

The Bill increases the limit for number of directorship that can be held by an individual from twelve to fifteen. [Clause 149(1)]

3. One director to be resident in India

A new requirement with respect to directors is that at least one director should have stayed in India for at least 182 days in the previous calendar year [Clause 149(3)]. This requirement appears to be a departure from the focus given in the Bill towards use of electronic mode such as use of video conferences for meetings/electronic voting. With the increasing use of electronic media the need for a director to be resident in India for a minimum amount of time, becomes redundant.

4. Independent Director

One of the significant aspects of the Bill is the effort made towards incorporating some of the salient requirements mandated by the SEBI in clause 49 of the Equity Listing Agreement in the Bill itself. To this effect, the Bill requires every listed public company to have at least one-third of the total number of directors as independent directors. Further, the Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies [Clause 149(4)]. The Bill also states that there are Rules to be prescribed in relation to the same and that the companies will have a period of one year to ensure compliance with the Bill and the Rules, if any, that are framed.

Conflicting requirements

While there have been attempts to harmonize the requirements of SEBI and the Bill there are several aspects relating to independent directors where the requirements of the Bill differ from that of Clause 49 of the Equity Listing Agreement. The requirements of the Bill and the manner in which they differ from those under Clause 49 of the Equity Listing Agreement include the definition[4] itself. The other main differences are:

- Clause 49 does not require the Board to exercise its judgement and opine on whether the Independent Director is a person of integrity or has relevant expertise or experience. This requirement poses difficulty in terms of the manner in which integrity of an individual can be assessed by the Board.
- Clause 49 does not require an examination of the independence of the relatives of independent directors. Extending the disqualification of the Independent Directors to consider the pecuniary relationship of the relatives would pose unnecessary hardship for the Independent Directors.
- The qualifications of Independent Directors has been left to be specified later.

Differing compliance requirements in respect of appointment of independent directors and their remuneration imposed by multiple regulators such as SEBI and MCA will lead to hardship as well increased cost of compliance for companies.

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[4] Definition:

Companies Bill 2012: An independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director,—

a. who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

b. (i) who is or was not a promoter of the company or its holding, subsidiary or associate company;
(ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

c. who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

d. none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

e. who, neither himself nor any of his relatives—

(i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

(ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of—

(A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

(B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;

(iii) holds together with his relatives two per cent. or more of the total voting power of the company; or

(iv) is a Chief Executive or director, by whatever name called, of any nonprofit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or

(f) who possesses such other qualifications as may be prescribed.

Clause 49 of Equity Listing Agreement:

'Independent director' shall mean a non-executive director of the company who:

a. apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates which may affect independence of the director;

b. is not related to promoters or persons occupying management positions at the board level or at one level below the board;

c. has not been an executive of the company in the immediately preceding three financial years;

d. is not a partner or an executive or was not partner or an executive during the preceding three years, of any of the following:

i. the statutory audit firm or the internal audit firm that is associated with the company, and

ii. the legal firm(s) and consulting firm(s) that have a material association with the company.

e. is not a material supplier, service provider or customer or a lessor or lessee of the company, which may affect independence of the director;

f. is not a substantial shareholder of the company i.e. owning two percent or more of the block of voting shares.

g. is not less than 21 years of age

While the Bill brings the constitution of the Board in India at par with other international capital markets i.e., by mandating at least one-third of the Board to be independent directors in case of listed companies, however, it is not synchronised with the requirements of Clause 49 of the Equity Listing Agreement, on account of the following:

- where the chairman of the Board is a non-executive director, at least one-third of the Board should comprise of Independent Directors and
- where the non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the company shall consist of independent directors.

Tenure of office: The Bill limits the tenure of office of an Independent Director to a maximum of two tenures of five consecutive years, with a cooling-off period of three years between the two tenures. During the cooling-off period of three years, such person should not be appointed in or be associated with the company in any other capacity, either directly or indirectly. [Proviso to clause 149(11)]

It is also relevant to note that the MCA had released the Corporate Governance Voluntary Guidelines in 2009, which permitted 3 tenures (with other conditions similar to those discussed above) for an independent director while as per the Clause 49 of the Equity Listing Agreement, an independent director cannot serve for more than nine consecutive years.

Stock Options: As per the Bill, an independent director will not be able to get stock options but may get payment of fees and profit linked commission subject to limits specified/to be specified in the rules [Clause149 (9)].

This, again, is in contradiction with SEBI's requirements where, for the purpose of granting stock options, the term employee includes independent directors also.

Databank of Independent Directors

The Bill proposes to make the appointment process of the Independent Directors independent of the company's management by constituting a panel or a data bank to be maintained by the MCA, out of which companies may choose their Independent Directors. The proposal has its origins in the Report of the 21st Standing Committee on Finance, wherein it was acknowledged that preparation of a databank of Independent Directors would vest with a regulatory body that may comprise of representatives of MCA, SEBI, Reserve Bank of India, Professional Institutions, Chambers of Commerce and Industry etc [Clause 150].

A drawback of constituting a panel of independent directors can be that it may discourage people from registering with the panel and in that sense limit the options available to a company for appointment of independent directors. Considering that the eligibility criteria of independent directors has been specified, constitution of a panel may complicate the appointment process and raise issues regarding the selection, verification, validation and management of independent directors in the panel.

Code for Independent Directors

The Bill includes Schedule IV 'Code for Independent Directors' (the "Code") which broadly prescribes the following for independent directors:

- professional conduct
- role and functions
- duties
- manner of appointment
- re-appointment
- resignation or removal
- holding separate meetings
- evaluation mechanism

The Code appears to be mandatory which would lead to some concerns including the following:

- The Code states that an Independent Director shall uphold ethical standards of integrity and probity, however what would constitute ethical behaviour is not defined and is open to interpretation.
- The Code does not give any cognizance to the need for training for Independent Directors.
- The Code refers to appointment of Independent Directors by the Board after evaluating certain attributes. The concern that remains unaddressed is the manner in which companies need to carry out an assessment of attributes of an Independent Director as specified under 'manner of appointment' in the Code from the databank maintained by the MCA.

Liability of Independent Directors

The Bill makes an attempt to distinguish between the liability of an Independent Director and Non-Executive director from the rest of the Board and has accordingly inserted a provision to provide immunity from civil or criminal action to Independent Directors. The intention and effort to limit liability of Independent Directors is demonstrated from the clause 149(12) of the Bill which inter-alia provides that liability for independent directors would be as under:

"only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently."

The clause seeks to provide immunity from civil or criminal action to independent directors in certain cases. Further, in accordance with the requirement of Clause 166 (2), the whole of the Board is required to act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interest of the company, its employees, the shareholders, the community and for the protection of the environment. By virtue of this clause, the duty of Independent Directors actually goes beyond its normal definition and is not restricted to executive directors only.

It is amply clear that Independent Directors have little or no defence and their obligations continues to remain a debatable topic since they would still be treated equivalent to other directors by holding them responsible for decisions made through board processes.

5. Appointment of an additional director

It is interesting to note that, in order to discourage inappropriate practices, the Bill now proposes that any person who fails to get elected as a director in the general meeting can no longer be appointed as an additional director by the Board of Directors. [Clause 161]

6. Additional compliance requirements for private companies

There are certain increased compliance requirements mandated for private companies which, till now, were mandated only for public companies and/or private companies which are subsidiaries of public companies. These include:

- appointment of director to be voted individually
- option to adopt the principle of proportional representation for appointment of directors
- Ineligibility on account of non-compliance with Section 274(1)(g) now extended for appointment/ reappointment as director in any private limited company also

Meetings of the Board and its powers

There have been significant inroads made by the MCA in the recent past with respect to giving cognizance to the use of electronic media in the day to day operations of corporates. The Bill takes this further by allowing use of electronic mode for sending notice of meetings [Clause 173(3)], passing of resolution by circulation [Clause 175] and other areas. Some of the other significant changes in relation to the Board and its functioning include:

1. Audit Committee

The requirements relating to Audit Committees was first introduced by the Companies (Amendment) Act, 2000. Audit Committees are a measure of ensuring self-discipline and are constituted with the object of strengthening and overseeing management in public companies and to ensure that the Board of directors discharge their functions effectively. The Bill acknowledges the importance of the Audit Committee and entrusts it with additional roles and responsibilities [Clause 177]. However, the fact that the Bill is not entirely in harmony with the requirements of Clause 49 of the Equity Listing Agreement cannot be ignored. While most of the requirements including establishment of a 'vigil mechanism' for directors and employees to report genuine concerns, similar to the requirements of Clause 49 of the Equity Listing Agreement have been incorporated in the Bill, the differences are:

- As per the Bill, the Audit Committee should have majority of Independent Directors.
- Chairman of the Audit Committee need not be an Independent Director.
- A majority of the members of the Audit Committee should be financially literate, i,e. should have the ability to read and understand the financial statements.
- Every listed company or such class (es) of companies as may be prescribed should establish a 'vigil mechanism' for directors and employees to report genuine concerns.

2. Nomination and Remuneration Committee and Stakeholders Relationship Committee

The Bill includes this new clause requiring constituting of the Nomination and Remuneration Committee by every listed company and such other class(es) of companies as may be prescribed. The Nomination and Remuneration Committee is required to formulate and recommend to the Board of Directors, the company's policies relating to the remuneration for the directors, key managerial personnel and other employees, criteria for determining qualifications, positive attributes and independence of a director [Clause 178(1)].

Further, the Board of a company having more than 1000 shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year is required to constitute a Stakeholders Relationship Committee [Clause 178(5)].

3. Contributions to charitable funds and political parties

The power of making contribution to 'bonafide' charitable and other funds is proposed to be available to the Board subject to certain limits, per the Bill [Clause 181]. As per the existing requirement of section 293 of the Act, power can only be exercised in the general meeting in case of public companies and subsidiaries of public companies.

Further, the limits of contribution to political parties is proposed to be increased to 7.5% of the average net profits during the three immediately preceding financial years [Clause 182] from the existing limit of 5% under the Act.

4. Disclosure of interest by directors

The Bill prescribes similar requirements in respect of disclosure of interest by director as contained in the existing section 299 of the Act. The only change that could be identified is that a contract or arrangement entered into by the company without disclosure of interest by a director or with participation by a director who is concerned or interested in any way, directly or indirectly, in the contract or arrangement, shall be voidable at the option of the company. [Clause 184]

5. Loans and investments by a company

The Bill proposes that companies can make investments only through two layers of investment companies subject to exceptions which includes company incorporated outside India [Clause 186]. There are no such restrictions which are currently imposed under the Act.

Further, the exemption available from the provisions of Section 372A of the Act to private companies as well as loans/investment given/made by a holding company to/in its subsidiary company are no longer available under the Bill.

6. Related Party Transactions

Most of the provisions under Clause 188 are quite similar to the requirements under Sections 297 and 314 of the Act. Some of key changes envisaged in the Bill include:

- the need for Central Government approval has been done away with
- the Bill has widened the ambit of transactions such as leasing of property of any kind, appointment of any agent for purchase and sale of goods, material, services or property

- ‘cash at prevailing market price’ has now been substituted with ‘Arm’s length transaction’ which has been defined in the Clause
- transactions entered into with related parties now to be included in the Board’s Report along with justification for entering into such contracts/ arrangements.
- penalty for contravention of the provisions of section 297 was covered in general provisions in the Act. However, this is now covered specifically in the Clause itself which now extends to imprisonment
- Central Government may prescribe additional conditions

Appointment and Remuneration of managerial personnel

The Bill brings significant changes to the existing requirements of the Act in respect of appointment and remuneration of managerial personnel. One of the major changes that could be identified is in respect of the applicability of these provisions. The provisions for appointment of managing director, whole time director or manager are no longer restricted to the public companies and private companies which are subsidiaries of public companies and are now applicable to all companies. The overall ceiling in respect of payment of managerial remuneration by a public company remains at 11 percentage of the profit for the financial year computed in the manner laid down in the Bill.

1. Appointment of managing director, whole time director or manager [Clause 196]

- The re-appointment of a managerial person cannot be made earlier than 1 year before the expiry of the term instead of 2 years as per the existing provision of section 317 of the Act, however, the term for which managerial personnel can be appointed remains as 5 years;
- The eligibility criteria for age limit have been revised to 21 years as against the existing requirement of 25 years. Further, the Bill lifts the upper bar for age limit and thus an individual above the age of 70 years can be appointed as Key Managerial Personnel by passing a special resolution;
- Provisions in respect of appointment of the managerial personnel has been specified in clause196 and Schedule V to the Bill

2. Overall maximum managerial remuneration and managerial remuneration in case of absence or inadequacy of profits [Clause 197]

- As against the existing requirement of section 198 of the Act which specifically provides that the provisions of managerial remuneration would be applicable to both public companies and private companies which are subsidiaries of public companies; the Bill states that such provisions would be applicable only to public limited companies.
- Listed companies have been mandated to disclose in the Board report, the ratio of remuneration of each director to median employee's remuneration and such other details as may be prescribed.
- The existing Act under section 309 provides that a managing director or a whole-time director of a subsidiary company who is in receipt of commission from the holding company cannot receive any commission or remuneration from the subsidiary company. The said restriction has been removed by the Bill, however, such receipt has to be disclosed in the Board's report [Clause 197(14)].
- The provisions of existing Schedule XIII of the Act have been incorporated in Schedule V of the Bill and the requirements have been structured around the same rules, with revised remuneration limits and certain additional requirements, for example, managerial personnel should not have been convicted of an offence under the Prevention of Money Laundering Act, 2002.
- The Bill appears to be liberalizing the administrative procedures by relaxing the requirement of obtaining Central Government approval provided company complies with certain conditions including seeking approval by way of special resolution for payment of managerial remuneration. Similar relaxation norms as envisaged in the Bill had been incorporated in Schedule XIII of the Act by virtue of the recent Circulars issued by MCA.
- Definition of remuneration has undergone few changes in the Bill. The Bill in clause 2(78), defines remuneration as any money or its equivalent given or passed to any person for services rendered by him and includes perquisites as defined under the Income-tax Act, 1961. The remuneration thus defined includes reimbursement of any direct taxes to managerial personnel. The Act defined remuneration under section 198 by way of an explanation and provided for certain specific inclusions that would be construed as remuneration. The Bill clarifies the fact that a company can pay remuneration which would include the tax liability settled by the company with the authorities [Also refer Section 200 of the Act].
- The Bill clarifies that premium paid by a company for any insurance taken by a company on behalf of its managing director, whole-time director, manager,

Chief Executive Officer, Chief Financial Officer or Company Secretary for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company would not be treated as part of remuneration except for the cases where person is proved to be guilty. The provisions cited above are similar to that of the existing provisions of section 201 of the Act.

3. Calculation of profits [Clause 198]

The Bill sets out in detail about the allowances and deductions that a company should include while computing the profits for the purpose of determining the managerial remuneration. To illustrate, the Bill states that while computing its profits, credit would not be given for any change in the carrying amount of an asset or of a liability recognized in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value.

What would be construed as fair value in this case is yet to be interpreted, as the concept of fair value is not commonly used in Indian accounting literature that is, generally accepted accounting practices in India.

4. Recovery of remuneration in certain cases [Clause 199]

The Bill contains stringent provisions in case the company is required to restate its financial statements pursuant to fraud or non-compliance with any requirement under the Bill and the rules made thereunder. As against the existing requirement of section 309 of the Act which only refers to the fact that excess remuneration paid to managerial personnel cannot be waived except with the previous approval of the Central Government, the Bill moves a step forward and enables the company to recover the excess remuneration paid (including stock options) from any past or present managing director or whole-time director or manager or Chief Executive Officer who, during the period for which the financial statements have been restated, has acted in such capacity.

5. Appointment of key managerial personnel [Clause 203]

The Bill provides for mandatory appointment of the following whole time key managerial personnel for class (es) of companies as may be prescribed, with an exception wherein the articles of association of a company may provide for appointment of an individual who can act as chairperson as well as managing director or Chief Executive Officer of the Company at the same time:

i. managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;

ii. company secretary; and

iii. Chief Financial Officer

Accounts and Auditors

» *Accounts*

» *Audit and Auditors*

Accounts

The Bill has introduced certain significant amendments in this chapter. The Bill proposes several additional requirements such as preparation of consolidated financial statements, additional reporting requirements for Directors in their Report such as development and implementation of risk management policy, disclosures in respect of voting rights not exercised directly by the employees in respect of shares to which the scheme relates etc., in comparison with the requirements of the existing Act.

1. Books of Accounts

Every company, similar to the requirement of the existing Act, is required to maintain books of accounts at its registered office [Clause 128(1)]. 'Books of accounts' are required to show (a) all money received and spent and details thereof, (b) sales and purchases of goods, (c) assets and liabilities and (d) items of cost as may be prescribed. The books of accounts of a company essentially provide the complete financial information of a company.

Further, with respect to branches, while the existing Act provides that where company has a branch office(s) proper summarized returns, made up to date at interval of not more than three months was supposed to be sent by branch to the company at its registered office or other place etc., such requirement has now been done away with and only returns are to be periodically sent by the branch to the registered office. [Clause 128(2)]

We believe that in addition to giving cognizance to Information Technology and global presence of Indian companies, cognizance should also be given to companies whose servers are maintained outside India and as long as access to add, modify and delete data exists in India, it should be considered as adequate compliance with the requirements of the Bill.

Also, in keeping with the times, books of accounts and/or relevant papers can now be maintained in electronic mode [Clause 128(1)]. Companies with a global presence, including Indian entities with subsidiaries, associates or branches outside India, for reasons of convenience or otherwise, set up their Information Technology ('IT') hubs outside India. In such cases, while Indian companies would be able to access, modify and manage data from India, the servers on which financial and other information resides would then be located outside India. This is a continuing issue for companies with global presence and a clarification is required as to whether such situations, i.e., where the companies' information resides on servers located outside India, would constitute sufficient compliance with the requirements of the Bill.

- *Cognizance given to electronic mode - Electronic mode of maintaining books of accounts has been given cognizance*
- *Reduction in compliance requirements / costs with respect to returns of branches -Requirement of returns to be sent by branches once in 3 months has been proposed to be done away with and returns are required to be sent periodically*

2. Cognizance of Accounting Standards

In several instances across the Bill, there are provisions which are also covered in the accounting standards currently notified under Section 211(3C) of the Act and the Companies (Accounting standards) Rules, 2006 thereunder.

There are certain differences in the manner in which a few terms have been defined under the Act. While the differences in some of these terms may not have any adverse impact, in certain cases, these differences may create implementation issues. Differences in definitions exist in the following cases:

- Associate company
- Control
- Subsidiary company
- Related Party

Associate Company: The Bill defines an associate company in Clause 2(6) as follows:

"Associate company", in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

Explanation.—For the purposes of this clause, "significant influence" means control of at least 20% of total share capital, or of business decisions under an agreement

This definition poses certain challenges since:

- It includes joint ventures
- Significant influence is defined to mean "control … of business decisions under an agreement"
- It differs from the definition of associate as per Accounting Standard 23: Accounting for Investments in Associates in Consolidated Financial Statements

The status of an associate and joint venture cannot be equated since, the degree of control that a company can exercise in such entities, varies significantly. While 'joint control' is the driving factor in case of joint ventures, a company can at most only 'participate' in the operating or financing decisions in case of an associate company.

With regard to the explanation to the clause which defines the term 'significant influence, it is to be noted that if a company has 'control' [control has been defined in clause 2(27) of the Bill] with respect to business decisions of another company, such other company would infact tantamount to a subsidiary and not an associate company. Hence, the use of the term 'control' in the definition of significant influence leads to a conflict between the two definitions (associate company and subsidiary company).

We believe that the terms associate, control and subsidiary, which have been defined in the accounting standards, which forms part of the existing Act, should not be defined again, in order to eliminate contradictions and ambiguity in compliance requirements. The concept of definitions of the accounting standards having primary significance has already been given cognizance in the Revised Schedule VI to the Act

Further, the definitions of the terms ‘associate’ and ‘significant influence’ are also not consistent with definitions in Accounting Standard 18: Related Party Transactions and Accounting Standard 23: Accounting for Investments in Associates in Consolidated Financial Statements (AS 23), which defines them as:

“An associate is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.”

“Significant influence is the power to participate in the financial and/ or operating policy decisions of the investee but not control over those policies.”

These definitions are contradictory to the extent that while the definition in the Bill includes joint ventures, AS 18/23 clearly states it is not a joint venture as well as the explanation of significant influence clearly contradicts the definition as per AS 18/23, since, the Bill refers to ‘control’ of business decisions, whereas AS 18/23 refer to ‘participation but not control in the financial and/ or operating policy decisions’.

With respect to these contradictions, specifically in case of associates, in the report of the Standing Committee on Finance on the Companies Bill, 2009, (‘Standing Committee Report’), the Ministry while responding to the difference in the definitions has justified it by stating *“The intent and objective behind provisions of the Bill and Accounting Standard (AS) 18 are not same. While AS 18 only deals with the accounting part, the Bill has to address the issues from the point of view of ensuring that directors or persons in control of the company do not take undue advantage of corporate form and do not use company‘s funds to their own advantage. Directors have the duty not to place themselves in a position when their fiduciary duties towards the company conflict with their personal interests.”*

To address the concern of the Ministry that a larger number of related companies are covered within the ambit of a specific requirement, rather than equating joint ventures with associates, an alternative would be to include the term ‘joint venture’ in all the relevant clauses where the term ‘associate’ has been used to extend the relevant requirements to joint ventures as well.

Subsidiaries: The term ‘control’, which is relevant with respect to identifying subsidiaries, has been defined in clause 2(27) of the Bill as:

“control” shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner

While this definition mandates consideration of ‘shareholding’ as one of the factors, the corresponding definition in AS 21: Consolidated Financial

Statements (AS 21), refers to 'voting power'. This issue is an existing one since a similar difference exists between the definition of 'subsidiary', where the term 'control' is relevant under the existing Act [Section 4(1)]. Accordingly, while for consideration of an entity as a subsidiary for the purpose of consolidated financial statements, reference is made to AS 21 and for the purpose of any compliance with the Act, reference is made to Section 4(1).

Now that the requirement of preparing consolidated financial statements has been included in the Bill itself, a conflict arises as to whether the definition as per the Bill should be considered for identifying a subsidiary or the definition as per the AS 21. In any case, the company will be non-compliant with the requirement of either the Bill or the AS 21.

With regard to related party, while there is a substantial difference between the definition under the Bill and AS 18, the difference does not impact the financial statements, since the disclosures in the financial statements will be continued to be made as per AS 18.

Contradictions between the definitions is the Bill and the notified accounting standards -Such conflicts will create ambiguity in the compliance requirements within the proposed enactment

3. Consolidated Financial Statements

The Bill now mandates Consolidated Financial Statements ('CFS') for any company having a subsidiary / associate / joint venture [Clause 129(3)]. The manner of consolidation is yet to be prescribed [Clause 129 (3)]. Further, the Bill requires adoption and audit of CFS in the same manner as stand-alone financial statements of the holding company [Clause 129(4)]. Apart from CFS, the Bill also requires separate statement containing the salient features of financial statements of its subsidiary (ies) in a form as may be prescribed [First proviso to Clause 129 (3)]. Further, clause 137(1), also requires an entity to file accounts of subsidiaries outside of India, along with the financial statements (including CFS).

With regard to preparation of CFS, the Standing Committee's recommendation was:

"The Committee find that the Ministry of Corporate Affairs have not agreed to the suggestion for providing automatic exemption to unlisted companies, from preparing consolidated financial statements for their subsidiaries or even allowing them to file only a statement of summary details as per the existing Section 212(3) of the Companies Act, 1956. The Ministry, have instead only proposed a minor modification in the sub-clause, while leaving the manner of consolidation of accounts by companies to rule-making. While endorsing the modification proposed, the Committee would recommend that the Ministry may re-consider the suggestion to exempt unlisted companies from preparing detailed consolidated financial statements of all their subsidiaries in the same form and manner as that of its own. Instead, they may be permitted to prepare only a summary statement in respect of their subsidiaries." [Emphasis added]

While clause 129 requires all companies to file a statement containing salient features of the subsidiaries financial statements, in addition to the CFS, clause 137 further requires entities with foreign subsidiaries to submit the individual financial statements of such foreign subsidiaries along with its own standalone and consolidated financial statements. There seems to be significant amount of overlap and additional burden on companies with respect to these compliances. To illustrate, in order to comply with these requirements, a company which has global presence with subsidiaries within and outside India will need to:

- Prepare its stand-alone financial statements [Clause 129(1)]
- Prepare CFS including all subsidiaries, associates and joint ventures (whether in India or outside) [Clause 129(3)]
- Prepare a summary statement for all its subsidiaries, associates and joint ventures of the salient features of their respective financial statements [Proviso to clause 129(3)]
- Submit the standalone financial statements of subsidiary(ies) outside India to the Registrar [Clause 137(1)]

This situation clearly indicates the extent of duplication and additional costs which will be incurred by entities in order to provide the same information in multiple forms / formats.

Differing compliance requirements imposed by multiple regulators will lead to hardship as well increased cost of compliance for companies.

We are of the view that these requirements necessiate significant streamlining to the effect that where certain companies are mandated to prepare and present CFS, they should not be further required to prepare the summary statement containing salient features. Further, since the company will inevitably, in compliance with the requirements of the accounting standards, consider even foreign subsidiaries, associates and joint ventures, there should be no further requirement to submit the individual financial statements of such entities.

The accounting standards contain detailed guidance regarding consolidation of subsidiaries, associates and joint ventures and these are covered under:

- AS 21: Consolidated Financial Statements (AS 21)
- AS 23: Accounting for Investments in Associates in Consolidated Financial Statements (AS 23)
- AS 27: Financial Reporting of Interests in Joint Ventures

Further, with regard to the form and content of the CFS, the CFS has to be prepared in the same format as that of stand-alone financials, in accordance with the prescribed schedule. In view of detailed requirements already set out under the accounting standards and the schedule to the Bill with regard to accounting as well as presentation and disclosures in the financial statements, the proviso to Clause 129(3) which states that the manner of consolidation will be prescribed, is unclear and redundant.

Increased cost of compliance:

- *Requirement for unlisted entities to prepare CFS, would substantially increase the cost of compliance. Further, it does not serve a similar purpose as in the case of a listed entity.*
- *Since there is already a requirement to attach a statement containing salient features of the financial statements of the subsidiary, associate and joint venture preparation of CFS would lead to duplication of preparing and presenting the same information in different forms.*

Duplication of compliance requirements:

- *It is proposed that the Central Government may provide for the consolidation of accounts of companies "in such manner as may be prescribed". The manner of consolidation (subsidiaries, associates or joint ventures) is already covered in the respective accounting standards (AS 21, 23 and 27) and there is no requirement for any specific rules in this regard. Accordingly, the relevance of this proviso is ambiguous and appears to be a duplication.*

4. Re-opening of accounts and voluntary revision of financial statements or Board's report

A company would be able to re-open its books of accounts and recast its financial statements after making an application in this regard to Central Government, the Income tax authorities, the SEBI, any other statutory regulatory body or authority or any other person concerned and an order is made by a court of competent jurisdiction or the Tribunal in the following circumstances [Clause 130]:

- the relevant earlier accounts were prepared in a fraudulent manner; or
- the affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of financial statements

Further, a company would be able to undertake voluntary revision of financial statements or Board's report if it appears to the director of a company that the financial statement of the company or the Board's report does not comply with the provisions of clause 129 (financial statements) and clause 134 (financial statements and board reports) in respect of any of three preceding financial years, after obtaining approval from Tribunal. The Tribunal shall give notice to the Central Government and the Income tax authorities and shall take into consideration the representations, if any, made by the Government or the authorities before passing any such order.

To prevent misuse of this specific provision, the clause contains a proviso which states that such revised financial statement or report shall not be prepared or filed more than once in a financial year and the detailed reasons for revision of such financial statement or report shall also be disclosed in the Board's report in the relevant financial year in which such revision is being made. [Clause 131]

The provisions envisaged by the Bill in respect of re-opening and voluntary revision of the financial statements and board report is yet to be acknowledged by SEBI in the equity listing agreement and thus, pending similar amendment in the equity listing agreement the listed companies may face unnecessary hardship.

5. Financial Year

The Bill has proposed a significant change in the definition of the term 'financial year', which has been defined in clause 2(41) as:

"Financial year", in relation to any company or body corporate, means the period ending on the 31st day of March every year, and where it has been incorporated on or after the 1st day of January of a year, the period ending on the 31st day of March of the following year, in respect whereof financial statement of the company or body corporate is made up:

Provided that on an application made by a company or body corporate, which is a holding company or a subsidiary of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, the Tribunal may, if it is satisfied, allow any period as its financial year, whether or not that period is a year:

Provided further that a company or body corporate, existing on the commencement of this Act, shall, within a period of two years from such commencement, align its financial year as per the provisions of this clause

While agreeing with the Ministry's view for providing uniformity in financial years, the Standing Committee had recommended that keeping in view the large number of suggestions received on this issue, a provision may be made for empowering the Tribunal to grant exemption from the applicability of this sub-clause to a class of companies.

There are several reasons for a company to use a year-end which is different from April to March. These include companies which are subsidiaries of foreign companies which follow a different year-end or entities which have significant subsidiaries outside India which need to follow a different year-end, etc. Accordingly, it would not be appropriate to mandate a single year-end for all companies. Since the Bill does not mandate any specific rules or requirements on the basis of a specific year, as in the case of tax laws, the reason for requiring a uniform year-end under the Bill, seems to be unclear.

Further, the recent notifications / circulars of the Ministry seem to indicate relaxation in norms for requiring approvals from the Tribunal / Central Government, etc for matters which are administrative or procedural. Accordingly, the option with companies to seek an exemption from the Tribunal is only going to create additional administrative and procedural roadblocks, with no benefits to the companies, rather, they will need to expend additional costs and time either by way of seeking an exemption or preparing multiple sets of financial statements.

Additionally, the situation where an exemption can be sought has been made very specific as follows:

"Provided that on an application made by a company or body corporate, which is a holding company or a subsidiary of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, the Tribunal may, if it is satisfied, allow any period as its financial year, whether or not that period is a year:"

In case of subsidiaries, associates or joint ventures, there are specific requirements with respect to the period covered by the financial statements of such entities which need to be considered for consolidation. For example, AS 21 requires the financial statements used in the consolidation to be drawn up to the same reporting date and allows a difference of 6 months, in case of impracticability. The proviso as referred above does not give cognizance to such requirement and will lead to a conflict with the accounting standards.

- *Lack of flexibility: Companies will lose the freedom of choosing their financial year.*
- *Increased cost of compliance: Companies have various reasons for using a statutory year different from the financial year and a mandate such as a uniform year end could potentially increase the cost of compliance since such companies will need to prepare their financial statements multiple times.*

Audit and Auditors

The Bill has proposed extensive changes in the area of audit and auditors with a view to enhance audit effectiveness and accountability of auditors. These changes undoubtedly, have a considerable impact on the audit profession. However, it needs to be noted that these changes will also have a considerable impact on the company in terms of the time, efforts and expectations involved. Apart from introducing new concepts such as rotation of audit firms and class action suits, the Bill proposes to increase the auditor's liability substantially in comparison with the existing Act.

1. Appointment of auditors

Unlike appointment at each annual general meeting under the Act, the Auditor will now be appointed for a period of 5 years, with a requirement to ratify such appointment at each annual general meeting [Clause 139(1)].

Further, the Bill provides that in respect of appointment of a firm as an auditor of a company, firm shall include a limited liability partnership incorporated under the Limited Liability Partnership Act, 2008. [Explanation to Clause 139(4)]

Also, the Bill specifies that where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm. [Clause 141]

Clause 141 further prescribes an additional list of disqualifications, and extends the disqualification to include relatives also. The Clause states that a person or his relative or partner who is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company of face value exceeding one thousand rupees or such sum as may be prescribed; is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of such amount as may be prescribed; or has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, for such amount as may be prescribed, will not be eligible to be appointed as an auditor. Additionally, a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed, will be disqualified from being appointed as an auditor.

The Bill also limits the maximum number of audit to twenty companies for a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor. [Clause 141 (3)(g)]

- ***Relative:*** *The definition of relative does not give cognisance to the Code of Ethics prescribed by ICAI and thus there are likely to be interpretational issues*
- ***Direct/Indirect interest:*** *The Bill does not specify as what would constitute as indirect interest and thus in absence of guidance it would be difficult to assess the extent of implication on the audit profession.*

Rotation of audit firm does not strengthen auditors independence and improve audit quality. Various studies and current policies around the world indicate that rotation of audit firms, in fact, defeats the very purpose for which it is proposed to be introduced.

There are several safeguards which provide sufficient protection to maintain the audit firm's objectivity and Independence. These safeguards also help in achieving a proper balance between the need for an in-depth knowledge and understanding of the client's business and its risks and the 'familiarity' risk of the audit firm with the client. Rather than mandatory firm rotation, we believe that audit partner rotation is more effective at mitigating familiarity threats to independence in a way that does not reduce audit quality.

2. Mandatory Firm Rotation

The Bill has introduced the concept of rotation of auditors and audit firms. The Bill proposes that in case of listed companies (and other class(es) of companies as may be prescribed) it would be mandatory to rotate auditors – every 5 years in case of the appointment of an individual as auditor and every 10 years in case of appointment of an audit firm with a uniform cooling off period of 5 years in both cases. Further, firms with common partners in the outgoing audit firm will also be ineligible for appointment as auditor during the cooling off period. The Bill has allowed a transition period of 3 years for complying with the requirements of rotation of auditors [Clause 139(2)]. Further, the Bill also proposes to grant an option to the shareholders to further require rotation of the audit partner and staff at such intervals as they may choose [Clause 139(3)].

Currently, while the Act does not have any requirements relating to auditor or audit firm rotation, the Code of Ethics issued by the Institute of Chartered Accountants ('ICAI') has a requirement to rotate audit partners in case of listed companies after every 7 years with a cooling off period of 2 years.

- ***Quality of Audits -*** *The auditor's cumulative knowledge of the company's business, people, processes, controls and risks plays a significant role in audit quality, which would be lost with shorter terms being mandated for the auditor.*
- ***Cost and complexity of audits -*** *Companies will be forced to spend extra time and effort to manage the rotation process and bring the new auditor up to speed.*
- ***Audit Committee effectiveness -*** *Audit committees and the investors they represent, may find that their freedom to decide which audit firm best suits the needs of their company and stakeholders is taken away by imposing mandatory audit firm rotation*
- ***Free market forces and market consensus -*** *Mandatory audit firm rotation reduces competition in the audit market because the current auditor would not be eligible, even if there is no alternative.*

3. Non-audit services to audit clients

The Bill proposes that any services to be rendered by the auditor should be approved by the Board of Directors or the Audit Committee. Additionally, the auditor is restricted from providing certain specific services, which include:

- Accounting and book keeping services
- Internal audit
- Design and implementation of any financial information system
- Actuarial services
- Investment advisory services
- Investment banking services
- Rendering of outsourced financial services
- Management services, and any other service which may be prescribed

Further, the Bill provides that such services cannot be rendered by the audit firm either directly or indirectly through itself or any of its partners, its parent or subsidiary or through any other entity whatsoever in which the firm or any partner of the firm has significant influence or control or whose name or trademark or brand is used by the firm or any of its partners [Clause 144]. The Act currently does not specify any requirements relating to non-audit services.

These restrictions are aimed at achieving auditor independence. Auditor independence is fundamental to public confidence on the reliability of auditors' reports. This concept adds credibility to published financial information and value to investors, creditors, companies, employees and other stakeholders. Independence is the audit profession's primary means of demonstrating to the public and regulators that auditors and audit firms are performing in line with established principles of integrity and objectivity. To comply with these independence norms the Bill provides for a transitional period of one year i.e. an auditor or audit firm who or which has been performing any non-audit services on or before the commencement of this Bill shall comply with these provisions before closure of the first financial year after the date of commencement.

- ***Costs -*** *Companies in multiple jurisdictions will need to employ significant resources to help them address the independence requirements in the respective jurisdictions.*
- ***Effectiveness -*** *Certain non-audit services which could be of benefit to the company and could enhance shareholder value, provided threats to the auditor independence are managed, cannot be provided*

We believe that it would be beneficial to adopt, or converge the standards of auditor independence in India to, the "threats and safeguards" approach to non-audit services in the International Ethics Standards Board for Accountants' (IESBA) Code of Ethics.

While we concur, that auditor independence should be of paramount importance, where a subsidiary is audited by another firm of Chartered Accountants, independence is not likely to be compromised and such situations should be considered.

4. Joint Audits

The Bill proposes that the members of the company may require that audit is conducted by more than one auditor [Clause 139(3)].

An audit of financial statements has a number of critical elements. These elements include detailed knowledge of and experience with the client's industry and its own business operations, careful planning that takes account of the client specific risks and controls, tests of controls and records, and conclusions about the results of audit testing and the overall accuracy of the financial statements. These elements cannot be readily separated between two audit firms and therefore both audit firms must invest significant resources to gain and maintain the necessary knowledge and experience.

- ***Costs -** When joint auditors are engaged, both firms must undertake and get paid for the engagement administration and client communication tasks that are endemic to all audit engagements.*
- ***Resources of the audit firms -** Need of both audit firms to devote resources to ensure that there is adequate communication between the firms relating to the audit.*
- ***Audit quality -** When two audit firms set out to share work in a manner that allows each of them to opine on those statements there is always a possibility that this will result in duplication of audit effort, resulting in unnecessary costs, as well as creating a risk that some items will fall through the cracks because neither firm has the complete picture.*
- ***Rotation -** One need to assess the impact of mandatory audit firm rotation in case of joint auditor as both will be considered/entitled for rotation at the same time.*

5. Auditors Liability

The scope and extent of auditor's liability, has been substantially enhanced under the Bill. Now, the auditor is not only exposed to various new forms of liabilities, but the liabilities prescribed in the existing Act have been made more stringent. The auditor is now subject to oversight by multiple regulators apart from the ICAI - The National Financial Reporting Authority ('NFRA', the body replacing the NACAS) is now authorized to investigate matters involving professional or other misconduct of the auditors. The penalty provisions and other repercussion that an auditor may now be subject to per the Bill includes:

Professional or other misconduct: The NFRA has the power to investigate, either suo moto or on a reference made to it by the Central Government, into the matters of professional or other misconduct committed by any member or firm of chartered accountants. Further, no other institute or body shall initiate or continue any proceedings in such matters of misconduct where the NFRA has initiated an investigation. Also, an appeal against the NFRA's order can be made at the Appellate Authority constituted by the Central Government. Where the NFRA proves professional or other misconduct, it has the power to:

- Impose penalty of not less than Rs.1 lakh, which may extend to five times of the fee received (individuals) and not less than Rs.10 lakhs, which may extend to ten times of the fees received (firms)
- Debar the member or the firm from engaging himself or itself from practice as member of the Institute of Chartered Accountants of India for a minimum period of 6 months or for such higher period not exceeding 10 years [Clause 132(4)]

Punishment for contravention of the law: Contraventions have been differentiated between contravention of specific provisions of the Bill knowingly or willfully with the intention to deceive the company/ shareholders/ creditors/ tax authorities and other contraventions. Where the contravention is with an intention to deceive, the auditor is punishable with imprisonment for a term extending to 1 year and fine ranging from Rs. 1 lac upto Rs.25 lacs and in case of any other contravention, he is punishable with a fine ranging from Rs. 0.25 lacs upto Rs.5 lacs. In all cases, he is liable to refund the remuneration received from the company and pay for damages to the company/ statutory bodies or authorities for loss arising out of incorrect or misleading statements made in his audit report [Clause 147(2)]

Additional repercussions in case of fraud/intent to defraud: The Tribunal can either suo moto or on an application made to it by the Central Government or by any person concerned, order a change of auditor if it is of the view that the auditor has directly or indirectly acted in a fraudulent manner or abetted or colluded in any fraud by the company/its directors/its officers. Additionally:

- Where the final order is passed by the Tribunal against the auditor, such individual or firm shall not be eligible for appointment as auditor of any company for 5 years from the date of passing of the order
- The auditor is liable for action under clause 447 which provides for imprisonment upto 10 years and fine upto 3 times the amount involved in the fraud, however, the Explanation I to the sub-clause provides that in case of a firm, the liability shall be that of the firm and that of every partner or partners who acted in fraudulent manner or abetted or colluded in any fraud by or in relation to, the company or its directors or officers. [Clause 140(5)]

Further, in case of issue of prospectus, where it is proved that the prospectus is issued with an intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, an auditor shall be held personally responsible without any limitation of liability for all and any losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus [Clause 35(3)]. Additionally, criminal liability is also extended to include auditors [Clause 34].

Similarly, in case of contravention of the specific clauses of the Bill, where it is proved that the partner or partners of the firm has/have acted in a fraudulent manner or colluded in any fraud by, or in relation to or by, the company or its directors or officers, the liability is deemed to be of the partner or partners concerned of the audit firm and of the firm jointly and severally. [Clause 147(5)]

While we welcome the proposals of the Bill which have been included to act as deterrents to willful contraventions or acts which perpetrate frauds or propogate misleading information, we believe that the extent of liability currently prescribed in the Bill in case of an auditor, is intimidating in nature rather than acting as a deterrent.

Clause 447 is a newly introduced clause which deals with punishment to individuals where such individuals are convicted for fraud. The penalties prescribed under this clause include:

- Imprisonment for a term not less than 6 months but which may extend to 10 years and
- Fine which shall not be less than the amount involved in the fraud, but which may extend to 3 times the amount involved in the fraud
- Further, where the fraud in question involves public interest, the term of imprisonment shall not be less than 3 years.

Class Action Suits: Apart from the above, now a class of shareholders can claim damages or compensation or demand any other suitable action against the auditor including the audit firm by way of class action suit, through filing an application with the Tribunal [Clause 245(1)]

Under the Act, if the auditor's report is not made or any document is signed or authenticated in a manner which is not in compliance with the requirements of the Act, the auditor would be subjected to penalty, if such default was willful [Section 233]. The Act additionally, has a provision of indemnifying the auditors [Section 201].

6. Additional responsibilities of the Auditor

The Bill proposes certain new aspects which need to be covered in an Auditors' Report. These include:

- the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company

> - *The repercussions on the auditor with respect to a prospectus which is issued fraudulently are also quite substantial, particularly where the auditor is not party to any fraudulent activity relating to the issue of prospectus.*
> - *Cognizance of Limited Liability Partnerships ('LLP') - while the Bill gives cognizance to LLPs by enabling appointment of LLPs as audit firms, the introduction of 'joint and several liability' creates a conflict with the provisions of the Limited Liability Partnership Act, 2008, which clearly does not extend the personal liability of a partner to the wrongful act or omission of any other partner of the LLP.*

  [Clause 143(3)(f)]

- any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith [Clause 143(3)(h)]
- whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls [Clause 143(3)(i)]

The Bill proposes that an auditor should report to the Central Government within such time and manner as may be prescribed, if he has any reason to believe that any offence involving fraud is being committed or has been committed against the company by its officers or employees [Clause 143(12)]. Further, where any auditor does not comply with the above required, he shall be punishable with fine which

With respect to the auditor's role as a whistle blower, we are of the view that considering the scope and inherent limitations of auditors' responsibility, the penalty imposed for failure of not reporting any fraud on the auditor, is not commensurate with the powers and duties bestowed on him by the Bill.

shall not be less than Rs.1 lakh but which may extend to Rs.25 lakhs [Clause 143(15)]. The above requirements are in addition to the existing requirements under the Act.

- ***Financial and other transactions not clarified -*** *The scope of reporting under the clause 143(3)(f) is vague and unclear. Also, it should be noted that the auditor's responsibility is limited to the extent of opining on the financial statements and matters related to it and not opining on the functioning of the company in its entirety.*
- ***Internal financial controls -*** *The requirement relating to reporting on adequate internal financial controls and operating effectiveness of such controls should be limited to those which may impact financial statements. Also quantum of work involved, particularly in case of small and medium enterprises for reporting on this clause, may be counter productive*
- ***Reporting frauds -*** *It should be appreciated that the auditor is not in a position to identify or investigate all the frauds which could potentially occur in various parts of the organization. Further, the auditor already has a responsibility to report on "fraud on or by the company has been noticed or reported during the year", as per the Companies (Auditors' Report), Order, 2003.*

Dividend

Dividend

The Bill proposes some significant changes to the existing provisions of the Act in respect of declaration of dividend. The changes are likely to affect the existing practices followed by companies with regard to the declaration of dividend.

The existing provisions of the Act in relation to transfer of specified percentage of profit to reserve is no longer applicable and thus the companies would be free to transfer any or no amount to its reserves.

There appears to be a conceptual shift in the basis of determining depreciation i.e. instead of using a specified rate, it would on the basis of useful life as specified in Schedule II of the Bill.

1. Declaration of Dividend

- The existing requirement of the Act with regard to transfer of specified percentage of profits not exceeding 10 percentage to reserve [i.e. Companies (Transfer of Profits to Reserve) Rules, 1975] has not been acknowledged in the Bill and thus the companies are free to transfer any or no amount of profits to reserves [Clause 123 (1)].
- Similar to the existing provisions of the Act, the Bill also provides that no dividend shall be declared or paid in case of inadequate profits by a company subject to the Rules yet to notified. The company also cannot declare or pay dividend from its reserves other than free reserves. [Clause 123(1)]. This could mean that Companies (Declaration of Dividend out of Reserves) Rules, 1975 have been retained.
- As per the existing provisions of the Act, dividend include interim dividend and all provisions of the Act which applies to final dividend equally applies to interim dividend. The Bill, however, imposes a further restriction on declaration of interim dividend. The Bill specifically provides that in case a company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, the interim dividend cannot be declared at a rate higher than the average dividends declared by the Company during the immediately preceding 3 financial years. [Clause 123(3)]

- The Bill states that if a company fails to comply with the provisions of acceptance of deposits and repayment of deposits accepted prior to the commencement of this Bill, it would not be able to declare any dividend on equity shares, as against the non-compliance of section 80A of the Act regarding redemption of irredeemable preference shares etc. [Clause 123(6)].
- The provision of existing Schedule XIV of the Act has been acknowledged under Schedule II of the Bill. Some important highlights from the Schedule II are:
  - the useful life or residual value of an asset have been specified in Part C of the Schedule; companies would be required to give disclosure for cases where the useful life or residual value is different from the useful life or residual value as specified in Part C of the Schedule
  - it is clarified in the Bill that the requirements off Part C would not be applicable for the companies in respect of which the useful life or residual value is notified by a Regulatory Authority
- The Bill does not give cognisance to the existing requirements of section 208 of the Act that deals with the power of company to pay interest out of capital in certain cases.

2. Transfer of shares to Investor Education and Protection Fund (IEPF)

As against the existing requirement of section 205C of the Act, the Bill proposes that all shares in respect of which unpaid or unclaimed dividend has been transferred to IEPF shall also be transferred by the company in name of the Fund along with a statement with certain specified details [Clause 124].

In addition to above, following amounts also needs to be transferred by the company to IEPF [Clause 125 (2)]:

- gain through the seizure and disposal of the securities in possession of a person who fictitiously acquires or subscribes for a Company's securities
- sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for 7 or more years
- redemption amount of preference shares remaining unpaid or unclaimed for 7 or more years

Additionally, the Bill specifies the following modes of utilisation of amounts available in IEPF:

- the refund of unclaimed dividends, matured deposits, matured debentures, application money due for refund and interest thereon
- distribution of any disgorged amount among investors who have suffered losses due to wrong actions by any person in accordance with the order of the Court that had decided for such disgorgement. In order to prevent misuse of the underlying securities, the investors can claim them back from IEPF through the provisions in the rules.
- reimbursement of legal expenses incurred in pursuing class action suits under Clauses 37 (misleading prospectus) and 245 (management or conduct of the affairs of the company being conducted in a manner prejudicial to the interests of the company or its members or depositors) by members, debenture-holders or depositors as sanctioned by the Tribunal
- any other purpose incidental thereto, in accordance with such rules as prescribed

Inspection, Inquiry and Investigation

Inspection, Inquiry and Investigation

Chapter XIV of the Bill corresponds to section 235 to section 251 of the Act and introduces certain stringent provisions for the cases of fraud and thus a company should take these requirements under consideration while evaluating the implications thereof.

1. Power to call for information, inspect books and conduct inquiries

As set out in the existing Act, the Registrar, apart from the inspector appointed by the Central Government is empowered to call for any information, explanation or documents and to inspect books of account of the company.

Where an application has been made by the Registrar to initiate investigation on account of fraudulent conduct of the business, and where business of a company has been or is being carried on for a fraudulent or unlawful purpose the company and every officer in default would be subjected to stringent provisions of clause 447 (also refer chapter on 'Other Matter') as applicable to fraudulent activities. [Clause 206]

2. Search and Seizure

Additionally the Registrar can also order search and seizure of documents if it has reasonable ground to believe that the same is likely to be destroyed, mutilated, altered or falsified with the permission of a special court. [Clause 209]

3. Investigation into affairs of company

Pursuant to the requirement of section 235 of the Act, the Central Government could order an investigation into the affairs of a company on the basis of report of Registrar; the provisions in the Bill have further been enlarged to include the following instances under which the Central Government could order such investigation [Clause 210]:

- intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or
- in public interest

4. Serious Fraud Investigation Office (SFIO)

The Bill accords a statutory status to SFIO. SFIO would be constituted by the Central Government and is proposed to be headed by a director and it's constitution would include experts from various disciplines [Clause 211].

The SFIO would be empowered to initiate investigation at the direction of the Central Government and has been vested with additional powers that empower SFIO to collect information from other regulatory authorities like Income Tax authorities, State Government etc.

Additionally, SFIO shall have power to arrest in respect of certain offences specified in the Bill which attract the punishment for fraud. These offences are cognizable and the person accused of any such offence shall be released on bail subject to certain conditions provided in the relevant clause of the Bill. [Clause 212]

5. Investigation into Company's affairs in other cases

The Bill continues to acknowledge the right of the members to approach Central Government for making an application to initiate an investigation into the affairs of the company. The only pertinent change is in respect of the number of members should agree for making an application to Central Government for investigation of the affairs of a company. The Bill states that, for a company having share capital, instead of the earlier requirement wherein application could be made if 200 members have accorded their approval, the application for investigation could now be initiated at the request of 100 members only. [Clause 213]

6. Procedures, powers, etc of Inspectors

The Bill specifically states that the inspector appointed by the Central Government would have the powers of civil court in respect of discovery and production of books and documents, summoning and enforcing the attendance of persons, examining of persons on oath and inspection of book, registers and other documents.

The Bill further states that in case of conviction, a director or officer would be deemed to have vacated his office from the date of conviction and would also be disqualified from holding office in any other company [Clause 217].

7. Protection of employees during investigation

This is a new clause that seeks to provide protection to the employees of a company during an investigation. If a company, during the course of investigation of affairs of the company, or during the pendency of any proceeding against the company concerned in the conduct and management of affairs of the company, proposes to discharge or suspend, terminate, change the terms of employment to the employee's disadvantage, dismiss or reduce in rank any employee, the company would be required to communicate the same to Tribunal by sending a previous intimation in writing of the action proposed to be taken against the concerned employee. The action against the employee can be taken only after addressing the objections of the Tribunal, if any, or, where approval is not received within 30 days of application made by the company. [Clause 218]

8. Freezing of assets of a company on an enquiry and investigation

According to this clause the Tribunal can order that no transfer, removal or disposal of funds, properties or assets would take place upto a period of three years subject to such conditions as it deems fit pursuant to:

- an inquiry or investigation into the affairs of a company or
- a reference by the Central Government or on complaint of members regarding oppression and mismanagement or
- a creditor having Rs. 1 lakh amount outstanding against the company or any other person having reasonable ground to believe that such transfer or disposal of funds/ assets are prejudicial to the interest of company, its shareholders, creditors or in public interest. [Clause 221]

9. Voluntary winding up of company, etc not to stop investigation proceedings

The clause specifically provides that an investigation can be initiated or if already initiated will not be stopped or dropped, inspite of the following reasons:

- an application has been made under clause 241 regarding prevention of oppression and mismanagement;
- the company has passed a special resolution for voluntary winding up; or
- any other proceeding for the winding up of the company is pending before the Tribunal [Clause 226]

The Bill accords statutory status to SFIO and has vested it with immense power such as arrest & collect information from alter regulatory authorities

The Bill further prescribes stringent provisions for the cases where fraud has been concluded during the investigation.

Compromises, Arrangements and Amalgamations

Compromises, Arrangements and Amalgamations

The Bill proposes some new provisions in the area of mergers and acquisitions, apart from making certain changes from the existing provisions. While the changes are aimed at simplifying and rationalising the procedures involved, the new provisions are also aimed at ensuring higher accountability for the company and majority shareholders and increasing flexibility for corporates.

The changes proposed would require companies to consider the scale and extent of compliance requirements while formulating their restructuring plans once the Bill is enacted. These changes are quite constructive and could go a long way in streamlining the manner in which mergers and other corporate scheme of arrangements are structured and implemented in India.

1. Streamlining requirements

The clause dealing with compromises and arrangements deals comprehensively with all forms of compromises and arrangements and extends to reduction of share capital, buy back, takeovers and corporate debt restructuring as well. Another positive inclusion in this clause is that the objection to any compromise or arrangement can now be made only by persons holding not less that 10% of shareholding or having outstanding debt amounting to not less than 5% of the total outstanding debt as per the latest audited financial statements [Clause 230]. Further currently, under the Act, an order does not have any effect until the same is filed with the Registrar of Companies. However, such requirement has been done away with under the Bill. The Bill merely requires filing of the order with the Registrar.

2. Mergers or division of companies

There are certain additional documents mandated to be circulated for the meeting to be held of creditors/ class of members (Clause 232). These include:

- draft of the proposed terms of the scheme drawn up and adopted by the directors of the merging company
- confirmation that a copy of the draft scheme has been filed with the Registrar
- report adopted by the directors of the merging companies explaining effect of the compromise

Act/section refers to Companies Act, 1956
Bill/clauses refers to Companies Bill, 2012 (As passed by Lok Sabha)

- report of the expert with regard to valuation
- supplementary accounting statement if the last annual accounts of any of the merging company relate to a financial year ending more than 6 months before the first meeting of the company summoned for the purpose of approving the scheme

3. Certifying accounting treatment

Currently, under the Companies Act, 1956, there is no mandate requiring companies to ensure compliance with accounting standards or generally accepted accounting principles while proposing the accounting treatment in a scheme. However, listed companies are required to ensure such compliance as the Equity Listing Agreement mandates such companies to obtain an Auditor's Certificate regarding appropriateness of the accounting treatment proposed in the scheme of arrangement. The Bill proposes to require all companies undertaking any compromise or arrangement to obtain such auditor's certificate [Clause 230, 232]. This requirement will help in streamlining the varied practices as well as ensuring appropriate accounting treatment. However, another aspect that is yet to be addressed is that the applicable notified accounting standards in India, currently, address only amalgamations and not any other form of restructuring arrangements.

4. Simplifying procedures

The current procedural requirements in case of merger and acquisition in any form are quite cumbersome and complex. There are no exemptions even in case of mergers between a company and its wholly owned subsidiaries. The Bill now proposes simplification of procedures in two areas, firstly, with holding-wholly owned subsidiaries and secondly, for arrangements between small companies being the other [Clause 233]. Small companies is a new category of companies, introduced in the Bill, with defined capital and turnover thresholds, which has been given certain benefits including simplified procedures.

One of the significant restrictions proposed in case of these situations is the restriction on the transferee company to hold any shares either in its own name or in the name of a trust, subsidiary or associate, since all shares will need to be cancelled or extinguished on the merger or amalgamation. This requirement will stem the practice followed by several companies which have in the past followed this route. Further, in certain cases, it has also rationalised the requirements, for example in case of reduction of share capital which is part of an compromise or arrangement, the company will need to comply with the provisions of this clause only, as against the existing requirement under the Act where the company is required to comply with the provision of section 108 in case of reduction of share capital as well those relating compromise.

5. Cross Border Mergers

The Act, allows merger of a foreign company with an Indian company, but does not allow the reverse situation of merger of an Indian company with a foreign company. The Bill now proposes to allow this flexibility, with a rider that any such mergers can be effected only with respect to companies incorporated in specific countries, the names of which, will be notified by the Central Government. With prior approval of the Central Government, companies are now allowed to pay the consideration for such mergers either in cash or in depository receipts or partly in cash and partly in depository receipts as agreed in the scheme of arrangement [Clause 234]. These new provisions could be greatly beneficial to Indian companies which have a global presence by providing them structuring options which do not exist currently.

6. Squeeze out provisions

The Bill has introduced new provisions for enabling the acquirer of a company (holding 90% or more shares) by way of amalgamation, share exchange, etc to acquire shares from the minority holders subject to compliance with certain conditions. This has also introduced the requirement for 'registered valuers', since the price to be offered by the majority shareholder needs to be determined on the basis of valuation by a registered valuer.[Clause 236]

- *Increased compliance and disclosure requirements - The new provisions as well as the changes from the existing provisions of the Act, are aimed at increasing the quantum and disclosures, thus enhancing transparency and streamlining various corporate restructuring models adopted by companies.*

Revival and rehabilitation of sick companies

Revival and rehabilitation of sick companies

1. Chapter XIX of the Bill lays down the provisions for 'Revival and Rehabilitation of Sick Companies'. The chapter describes in seriatim, the circumstances which determine the declaration of a company as a sick company and also includes the rehabilitation process of the same. Although the chapter aims to provide comprehensive provisions for revival and rehabilitation of sick companies, the fact that several provisions such as particulars, documents and content of the draft scheme in respect of application for revival and rehabilitation etc. have been left to substantive enactment, leaves scope for interpretation.
2. The coverage of SICA, 1985 is limited to only Industrial companies, while the Bill covers the revival and rehabilitation of all companies irrespective of their sector.
3. The determination of the sickness of a company would no longer be based on a situation where accumulated losses exceed networth rather it would be determined on the basis whether the company is able to pay its debts. In other words, the determining factor of a sick company has now been shifted to the secured creditors and/ or banks and financial institutions with regard to assessment of a company as a sick company;
4. The Bill does not recognise the role of all the stakeholders in the revival and rehabilitation of a sick company and provisions predominately revolve around secured creditors. The Bill recognises the presence of unsecured creditors only at the time of the approval of the scheme of revival and rehabilitation. To substantiate, in accordance with the requirement of clause 253 of the Bill, a company is assessed to be a sick company on a demand by the secured creditors of a company representing fifty per cent or more of its outstanding amount of debt in the following circumstances:
    - the company has failed to pay the debt within a period of thirty days of the service of the notice of demand or
    - the company has failed to secure or compound the debt to the reasonable satisfaction of the creditors.
5. To speed up the revival and rehabilitation process the Bill proposes a one year time period for the finalization of the rehabilitation plan.

Summary of key provisions

1. In response to the application made by either the secured creditor or by the company itself, if the Tribunal is satisfied that a company has become a sick company, it shall give time to the company to settle its outstanding debts if Tribunal believes that it is practicable for the company to make the repayment of its debts within a reasonable time.

2. Once a company is assessed to be a sick company, an application could be made to Tribunal under clause 254 for determination of the measures that may be adopted with respect to the revival and rehabilitation of an identified sick company either by a secured creditor of that company or by the company itself. The application thus made should be accompanied by audited financial statements of the company relating to the immediately preceding financial year; a draft scheme of revival and rehabilitation of the company; and with such other document as may be prescribed.

   Subsequent to the receipt of the application, for the purpose of revival and rehabilitation the Tribunal shall, not later than seven days would be required to fix a date for hearing and would be appointing an interim administrator under clause 256 to convene a meeting of creditors of the company in accordance with the provisions of clause 257 of the Bill. In certain circumstances, the Tribunal may appoint an interim administrator as the company administrator to perform such functions as the Tribunal may direct.

3. The administrator thus appointed would be required to prepare a report specifying the measures for revival and rehabilitation of the identified sick industry. The measures that have been identified in the clause 261 of the bill for the purpose of revival and rehabilitation of sick company provides for the following options:

   - financial reconstruction;
   - change in or takeover of the management;
   - the amalgamation of sick company with any other company or another company's amalgamation with sick company.

4. The Scheme thus prepared would be approved by the secured and unsecured creditors representing three fourth and one fourth of the total representation in amounts outstanding respectively, before submission to the Tribunal for sanctioning the scheme pursuant to the requirement of clause 262. The Tribunal, after examining the scheme would give its approval with or without any modification. The Scheme, thus approved would be communicated to the sick company and the company administrator and in the case of amalgamation, also to any other company concerned.

5. The sanction accorded by the Tribunal would be construed as conclusive evidence that all the requirements of the scheme relating to the reconstruction or amalgamation or any other measure specified therein have been complied with. A copy of the sanctioned scheme would be filed with the Registrar by the sick company within a period of thirty days from the date of its receipt.
6. However, if the scheme is not approved by the creditors, the company administrator shall submit a report to the Tribunal within fifteen days and the Tribunal shall order for the winding up of the sick company. On the passing of an order, the Tribunal shall conduct the proceedings for winding up of the sick company in accordance with the provisions of Chapter XX, Winding Up.

Companies incorporated outside India

Companies incorporated outside India

1. The existing Act requires submission of certain documents by a foreign company to the Registrar. In addition to the existing list of documents, the foreign company would also be required to submit following with the Registrar [Clause 380]:
   - i. Particulars of opening and closing of a place of business in India on earlier occasion or occasions; and
   - ii. declaration that none of the directors of the company or the authorised representative in India has ever been convicted or debarred from the formation of companies and management in India or abroad.
2. The existing requirement of the Act with regard to display of name etc. of foreign company in every prospectus inviting subscription in India for its shares or debentures is no longer envisaged [Clause 382];
3. The Bill recognises the electronic mode of service of document on foreign company [Clause 383];
4. The existing Act under section 600 states that a foreign company needs to comply with provisions of specific sections such as 118 and 209 of the Act. In addition to these sections, the Bill further states that provisions relating to Inspection, Inquiry and Investigation would also apply mutatis mutandis to a foreign company [Clause 384];
5. In respect of provisions dealing with dating of prospectus and particulars contained thereon, the defence available to a director or other person responsible for the prospectus in respect of non-compliance with or contravention of any of the requirements of this clause, has not been acknowledged [Clause 387];
6. With regard to closure of the place of business of a foreign company in India, the provisions of Chapter XX that deals with winding up would apply mutatis mutandis to a foreign company also [Clause 391]

Other Areas

- *Acceptance of deposits*
- *Registered valuers*
- *Winding – up*
- *Dealing with fraud*
- *Shareholder democracy*
- *Corporate social responsibility*
- *Removal of names of companies from the register of companies*
- *Few key concepts*

Acceptance of deposits

It is pertinent to note that the requirements relating to acceptance of deposits are already quite stringent under the Act and the Rules made thereunder. The Bill proposes to further streamline the same. A significant impact of the proposals in the Bill is that only those public companies which meet the prescribed net worth or turnover criteria may accept deposits from persons other than its members. Other companies can accept deposits only from its members.

The proposed provisions will enhance the protection of the deposit holders. Companies will have to incur additional costs due to requirements related to credit rating, maintenance of additional liquid funds, deposit insurance etc.

1. Acceptance of deposits

The Bill proposes that only those companies which meet such net worth or turnover criteria as may be prescribed will be eligible to accept deposits from persons other than its members. Such companies will also be required to obtain the rating (including its networth, liquidity and ability to pay its deposits on due date) from a recognised credit rating agency which ensures adequate safety. [Clause 76(1)]

Companies which do not meet the net worth or turnover criteria will only be able to accept deposits from its members. [Clause 73(2)]

All companies will be required to comply with the prescribed conditions which includes issuance of circular to its members, obtaining credit rating, providing deposit insurance, maintaining deposit repayment reserve account etc. [Clause 73(2)]

2. Outstanding deposits

The Bill proposes that deposits accepted before the Bill comes into force will need to be repaid within one year from the commencement of the Bill or when such payments are due, whichever is earlier [Clause 74(1)]. This is likely to create significant financial impact on companies which have currently accepted deposits and will not meet the eligibility criteria under the Bill.

3. Protection of depositors

An amount equivalent to a minimum 15% of deposits maturing during the financial year as well as the following financial year will need to be kept in a separate bank account with a scheduled bank. The Companies (Acceptance of Deposits) Rules, 1975 currently require that 15% of deposits maturing during the financial year should be kept in bank or invested in specified securities [Clause 73(2)].

Additionally, the Bill also proposes that deposit insurance as prescribed will also be required to be provided [Clause 73(2)].

Registered Valuers

The Bill has introduced a new concept of registered valuers who are required for providing valuation reports mandated under various clauses. These include:

- Further issue of share capital [Clause 62]
- Restriction on non-cash transactions involving directors [Clause 192]
- Compromises, arrangements and amalgamations [Clause 230]
- Purchase of minority shareholding [Clause 236]
- Submission of report by Company liquidator [Clause 281]
- Declaration of solvency in case of proposal to wind up voluntarily [Clause 305]
- Power of Company liquidator to accept shares, etc., as consideration for sale of property of company [Clause 319]

However, it should be noted that the qualification, experience and the process of registration as a valuer are yet to be prescribed [Clause 247].

Winding-up

1. Chapter XX of the Bill consisting of clauses 270 to 365 deals with the provisions for winding-up of companies. The Act prescribes three modes of winding-up

   i. by Court;

   ii. under supervision of Court; and

   iii. voluntary

As against the existing modes of winding-up as prescribed by the Act, the Bill prescribes following two modes:

   i. by the Tribunal; and

   ii. voluntary

2. The Bill does not acknowledge the distinction between members voluntary winding up and creditors voluntary winding up. Additionally, following are the new grounds of winding-up by Tribunal:

   a. The company has acted against the interests of sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;

   b. Order has been made under Chapter XIX (Revival and Rehabilitation of Sick Companies);

   c. An application has been made by the Registrar or any other person authorized by the Central Government by notification under the Bill, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;

   d. The company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years

Dealing with Fraud

1. The Bill deals extensively with fraud [Clause 447] and has for the first time defined fraud specifically as:

"Fraud in relation to affairs of a company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss"

"Wrongful gain" means the gain by unlawful means of property to which the person gaining is not legally entitled and "Wrongful loss" means the loss by unlawful means of property to which the person losing is legally entitled [Explanation to Clause 447]

2. Further, the penalties as prescribed in this clause are as follows:
   - imprisonment for a term not less than 6 months but which may extend to 10 years and
   - fine not less than the amount involved in the fraud, but which may extend to 3 times the amount involved in the fraud
   - Also, where the fraud in question involves public interest, the term of imprisonment shall not be less than 3 years.

3. The provisions of this clause have a significant impact and there are various aspects across the Bill, which would lead a person to be liable under this clause. Some of these areas are:
   - Where a person furnishes any false or incorrect particulars of any information or suppresses any material information in relation to incorporation of a company filed with the Registrar [Clause 7(5) and (6)]
   - In case of formation of company with charitable purpose, where it is proved that the affairs of the company were conducted fraudulently, every officer in default [Clause 8(11)]
   - Where a prospectus issued, circulated or distributed includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorizes the issue of such prospectus [Clause 34]
   - Fraudulently inducing persons to invest money [Clause 36]
   - Personation for acquisition, etc. of securities [Clause 38]

- Where any depository or depository participant, has transferred shares with an intention to defraud a person [Clause 46(6)]
- Failure to repay the deposit or part thereof or any interest thereon within the time limits as applicable and where it is proved that such deposits were accepted with intent to defraud the depositors or for any fraudulent purpose [Clause 75]
- Where the Tribunal is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers [Clause 140(5)]
- Where it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers [Clause 147(4)]
- Penalty for furnishing false statement, mutilation, destruction of documents [Clause 229]

Shareholder Democracy

Acknowledging the concept of shareholder democracy, various provisions have been incorporated in the Bill. These provisions can be broadly summarised as under:

- Shareholder rights/protection
- Special consideration to small shareholders

1. Shareholder rights/protection

Class Action Suits: A class action is a legal form of lawsuit where a large group of individuals collectively bring a claim to court and/or in which a particular class of defendants is being sued. The concept of collective lawsuit finds its roots of origination in the United States, where it is still predominantly prevalent. In several European countries changes have been made recently in their civil law, to allow consumer organizations to bring claims on behalf of large groups of consumers.

Acknowledging the increasing need for class action lawsuit, the Bill has empowered the shareholders associations or group of shareholders to take legal action in case of any fraudulent action on the part of company and to take part in investor protection activities and 'Class Action Suits'. [Clause 245]

Additionally, in response to the Standing Committee's recommendation in its Twenty First Report for ensuring protection of interests of minority shareholders and small investors, the Ministry suggested that during adjudication on Class Actions Suits, the Tribunal would ensure that the interests of shareholders are protected and wrongdoers, including auditors and audit firms, are required to compensate the victims on suitable orders by Tribunal.

Also, as stated in the Bill, Central Government will have power to prescribe class or classes of companies which shall not be permitted to allow use of proxies.

2. Special consideration to small shareholders

The Bill acknowledges the existing rights of the small shareholders envisaged in section 252A of the Act in the following clauses:

- A listed company may have one director elected by such small shareholders in such manner and with such terms and conditions as may be prescribed. Here "small shareholders" means a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed. [Clause 166]
- The Board of Directors of a company which consists of more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year shall constitute a Stakeholders Relationship Committee consisting of a chairperson who shall be a non-executive director and such other members as may be decided by the Board. Further, the clause under sub-clause 6 recognises the concept of Stakeholders Relationship Committee which shall consider and resolve the grievances of security holders of the company.[Clause 178]

The concept of class action suit considering the best interest of the shareholders is a welcome provision. However, the fact that there are always possibilities of misuse cannot be ignored and a manner should be prescribed to prevent misuse of these provisions.

Additionally, it is imporatnat to note that India being a developing economy, it may be difficult to appreciate the concepts of 'class action suits'. It could only be successful, if implemented after detailed research.

- Specific disclosure in the scheme of mergers/ amalgamation regarding effect of merger on minority shareholders to be provided.
- Under various clauses in the Bill, for example, variation in terms of contract or object in prospectus, the dissenting shareholders have been provided with an option to exit which act as a protection to the interest of small shareholders.

Corporate Social Responsibility

The Ministry had introduced certain voluntary guidelines in respect of corporate social responsibility. These guidelines are expected to enjoy legal sanctity on acknowledgement in the Bill. The clause in the Bill seeks to provide that every company having networth of Rs. 500 crore or more or turnover of Rs. 1000 crore or more or net profit of Rs. 5 crore or more during any financial year shall constitute the Corporate Social Responsibility Committee of the Board. The composition of the committee shall be included in the Board's Report. The Committee shall formulate the policy including the activities specified in Schedule VII. The Board shall disclose the contents of policy in its report and place on website, if any of the company. The Bill mandates that these companies would be required to spend atleast 2 percentage of the average net-profits of immediately preceding 3 years on CSR activities, and if they do not spend, explanation of the reasons thereof should be given in the Director's Report. [Clause 135]

Companies should not be forced to spend a specific amount on CSR – this should be left to the option of companies. Encouragement should be given to CSR initiatives and same should not be made compulsory.

Removal of names of companies from the register of companies

The provisions of Chapter XVIII regarding removal of names of companies from the register of companies correspond to the existing section 560 of the Act. The Bill lays down similar requirement as that of the Act i.e. where the Registrar has reasonable cause to believe that -

- a company has failed to commence its business within one year of its incorporation;
- the subscribers to the memorandum have not paid the subscription which they had undertaken to pay within a period of one hundred and eighty days from the date of incorporation of a company and a declaration under sub-section (1) of clause 11 to this effect has not been filed within one hundred and eighty days of its incorporation; or
- a company is not carrying on any business or operation for a period of two immediately preceding financial years and has not made any application within such period for obtaining the status of a dormant company under clause 455

it shall send a notice to the company and all directors of the company, of its intention to remove the name of the company from the register of companies and requesting them to send their representations along with copies of the relevant documents, if any, within a period of thirty days from the date of the notice.

Few key concepts

1. Private company

The Bill introduces a change in the definition for a private company, inter-alia, the new requirement increases the limit of the number of members from fifty to two hundred. [Clause 2(68)]

2. Officer

The definition of officer has been extended to include promoters and key managerial personnel [Clause 2(59)]

3. Promoter

The term promoter has been defined, as a person -

a. who has been named as such in a prospectus or is identified by the company in the annual return referred to in clause 92 that deals with Annual return; or

b. who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or

c. in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act.

The proviso to this clause states that sub-clause (c) would not apply to a person who is acting merely in a professional capacity. [Clause 2(69)]

4. Subsidiary

The definition of subsidiary as included in the Bill states that certain class or classes of holding company (as may be prescribed) shall not have layers of subsidiaries beyond such numbers as may be prescribed. With such a restrictive clause, it appears that a holding company will no longer be able to hold subsidiary beyond a specified number. [Clause 2(87)]

5. Small Company

A small company has been defined as a company, other than a public company,-

i. paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees; or

ii. turnover of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees

As set out in the Bill, this clause will not be applicable to the following:

a. a holding company or a subsidiary company;

b. a company registered under section 8; or

c. a company or body corporate governed by any special Act. [Clause 2(85)]

6. Dormant company

The Bill states that a company can be classified as dormant company where it is formed and registered under this Bill for a future project or to hold an asset or intellectual property and has no significant accounting transaction[5]. Such a company or an inactive company[6] may make an application to the Registrar in such manner as may be prescribed for obtaining the status of a dormant company. [Clause 455]

7. Secretarial audit for bigger companies

In respect of listed companies and companies belonging to a prescribed class, the Bill provides for a mandatory requirement to have secretarial audit. As specified in the Bill, the companies would be required to annex a secretarial audit report given by a Company Secretary in practice with its Board's report. [Clause 204]

8. Internal Audit

The importance of internal audit has been well acknowledged in Companies (Auditor Report) Order, 2003 (the 'Order'), pursuant to which auditor of a company is required to comment on the fact that that the internal audit system of the company is commensurate with the nature and size of the company's operations.

5 Explanation to section 455: significant accounting transaction" means any transaction other than—
(a) payment of fees by a company to the Registrar;
(b) payments made by it to fulfil the requirements of this Act or any other law;
(c) allotment of shares to fulfil the requirements of this Act; and
(d) payments for maintenance of its office and records

6 Explanation to section 455: "inactive company" means a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years;

The Bill now moves a step forward and mandates the appointment of an internal auditor who shall either be a chartered accountant or a cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.

However, the class or classes of companies which shall be required to mandatory appoint an internal auditor is yet to be prescribed.[Clause 138]

9. Specify audit of items of cost

The Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies. By virtue of this clause the cost audit would be mandated for certain companies. [Clause 148]

It is interesting to note that similar requirements have recently been notified by Central Government.

10. Auditing Standards[7]

The Standard on Auditing have been accorded legal sanctity in the Bill and soon would be subject to notification by NFRA. Auditors are now mandatorily bound by the Bill to ensure compliance with standards on auditing.

11. National Company Law Tribunal (Tribunal/NCLT)

In accordance with the Supreme Court's judgment, on May 11, 2010 on the composition and constitution of the Tribunal, modifications relating to qualification and experience, etc. of the members of the Tribunal has been made. Appeals from Tribunal shall lie to Appellate Tribunal. Chapter XXVII consisting of clause 407 to 434 deals with NCLT and Appellate Tribunal.

7 auditing standards" means the standards of auditing or any addendum thereto for companies or class of companies referred to in sub-section (10) of section 143

12. Prohibition of association or partnership of persons exceeding certain number

The Bill puts a restriction on number of partners that could be admitted to a partnership at hundred. To be specific the Bill states that no association or partnership consisting of more than such number of persons as may be prescribed shall be formed for the purpose of carrying on any business that has for its object the acquisition of gain by the association or partnership or by the individual members thereof, unless it is registered as a company under this Act or is formed under any other law for the time being in force:

As an exception, the aforesaid restriction would not apply to -

a. a Hindu undivided family carrying on any business; or

b. an association or partnership, if it is formed by professionals who are governed by special Acts like Chartered Accountants Act etc. [Clause 464]

13. Power to remove difficulties

Central Government to have power to exempt/modify provisions of the Act for a class or classes of companies in public interest. Relevant notification shall be required to be laid in draft form in Parliament for a period of thirty days. The Bill further states no such order shall be made after the expiry of a period of five years from the date of commencement of clause 1 of this Bill. [Clause 470]

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