The Companies Act, 2013 and Company Secretaries

The Companies Act, 2013 has considerably enhanced the role and responsibilities of company secretaries both in employment and in practice. They need to gear up to meet the challenges and rise to the occasion. This article highlights the provisions in the law relating to company secretaries.

Background

The Companies Bill, vetted twice by the Parliamentary Panel, was passed by the Lok Sabha on December 18, 2012 and by the Rajya Sabha on August 8, 2013. On receiving the assent of the Hon'ble President of India on August 29, 2013, it was notified on August 30, 2013 as the Companies Act, 2013 (Act 18 of 2013) consisting of 470 Sections and 7 Schedules.

The Companies Act, 2013 (hereafter 'The Act') is a historic legislation all set to replace the existing company law, which is 56 years old. It consolidates and amends the law relating to the companies and intends to improve corporate governance and to further strengthen regulations for the corporate sector. It is a modern and contemporary law, enacted after several rounds of deliberations with various stakeholders. It moves from the regime of control to that of liberalisation/self-regulation. In appropriate cases, it enables the authorities to make rules through subordinate legislation, thus ensuring that the law remains relevant at all times in the changing economic environment. It demonstrates the Government's commitment to ushering in a new era of corporate regulation.

Major corporate frauds and misdemeanours witnessed in recent times, which were the consequences of mismanagement and gross neglect of legal and compliance requirements by certain companies, have affected the image of the country in general, and the corporate sector in particular. These could have been avoided if proper compliance procedures had been followed and due diligence

was exercised by relevant experts and professionals associated with such companies. The Act has put in place suitable mechanisms to guard against such incidents. The success of these initiatives would largely depend upon how diligently the professionals discharge their responsibilities in furtherance of objectives sought to be achieved through such mechanisms.

The Act broadly seeks to achieve the following objectives:

a. To promote the development of the economy by encouraging entrepreneurship and enterprise efficiency and creating flexibility and simplicity in the formation and maintenance of companies;

b. To encourage transparency, accountability and high standards of corporate governance;

c. To recognize various new concepts and procedures facilitating ease of doing business while protecting interests of all the stakeholders;

d. To enforce stricter action against fraud and gross non-compliance with company law provisions;

e. To set up institutional structure in the form of various authorities, bodies and panels as well as by including recognition of various roles for professionals and other experts;and

f. To cater to the need for more effective and time bound approvals and compliance requirements relevant in the present context.

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Role of Company Secretaries

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The professionals and legal experts provide a very important link between the regulated entities and the regulatory bodies. Internationally, their role is being recognised increasingly. Indian statutes too have been suitably taking note of this important development.

The Act has incorporated a framework which is based on self-regulation but with enhanced disclosures and accountability on the part of companies and their managements. The corporate sector will be required to exhibit responsible self-regulation and corporate governance on their part, which necessitates the services of independent, competent and responsible governance professionals. From this perspective, company secretaries, would be required to play a very important role in implementation of the Act. The Act expects the company secretary to play a wider role in terms of guiding the activities of a company, in addition to certifying its compliance-oriented actions.

The Act has substantially strengthened the role and position of the company secretaries. In particular, it considers a company secretary as a key managerial personnel. While this is expected to enhance the position of a company secretary, it also casts responsibility on him for due compliance with the provisions of law. It should also be noted that for non-compliance of the provisions of law, he is also an “officer-in-default” thus, subject to liability under relevant penal provisions.

Some of the key areas contained in the Act which will directly

Section 203 provides for compulsory appointment of whole-time Key Managerial Personnel (KMP) in respect of certain class of companies to be prescribed by Central Government. A company secretary is covered under the term "whole-time KMP". Thus, the appointment of company secretary will become mandatory in respect of such class of companies.

impact the role of company secretaries in employment or in practice are discussed below:

(a) Introduction of Secretarial Audit(Section 204)

Based on the recommendations made by the Honourable Parliamentary Standing Committee, Secretarial Audit has been introduced for the first time in section 204 of the Companies Act, 2013. Under the section, every listed company and a company belonging to such class as may be prescribed in the rules, shall annex with its Board's report a Secretarial Audit Report, given by a company secretary in practice. If any qualifications or observations or other remarks are made by the company secretary in practice in his report, the Board shall provide explanation for the same in its report. Stringent penal provisions have been provided for non-compliance.

The introduction of Secretarial Audit proves that Government is committed to improved corporate compliance and governance. This provision highlights the enhanced role the company secretaries in practice are expected to play under the Act.

(b) Secretarial Standards(Section 118)

The Act gives statutory recognition to the Secretarial Standards specified by the ICSI. It is the beginning of a new era where besides Financial Standards, non-financial standards have been given importance and statutory recognition.Section 118(10) mandates that every company shall observe Secretarial Standards with respect to general and board meetings as specified by the ICSI and approved by the Central Government. In view of this statutory provision, it is hoped that the ICSI will focus on specifying appropriate Secretarial Standards and ensuring their periodic review and updation so that they are relevant and meet the expectations of the company secretaries, corporate sector and other stakeholders.

(c) Annual Return(Section 92)

The annual return is a comprehensive document and contains information about the company relating to its share capital, directors, shareholders, changes in directorships, etc. Much reliance is placed on the annual return by the regulators, shareholders, judicial and other regulatory authorities.

Under the Companies Act of 1956, the annual returns of listed companies are required to be signed by a company secretary in practice. Section 92 of the Act has further widened this requirement by providing that annual returns of companies having such paid up share capital and turnover as may be prescribed shall also be required to be certified by a company secretary in practice. The certification shall be to the effect that the company has complied with all the provisions of the Act. Further, prescribed extracts of the annual return shall be included in the Board's report. These provisions seek to ensure that information filed through annual returns in the Registry is properly verified by qualified professionals.

(d) Appointment of Whole-time Key Managerial Personnel (Section 203)

The role of senior management in managing the affairs of the company is crucial in ensuring good corporate governance and regulation. In order to ensure that companies of a prescribed class are effectively managed by a whole time managerial personnel, Section 203 provides for compulsory appointment of whole-time Key Managerial Personnel (KMP) in respect of certain class of companies to be prescribed by Central Government. A company secretary is covered under the term "whole-time KMP". Thus, the appointment of company secretary will become mandatory in respect of such class of companies.

(e) Functions of Company Secretary (Section 205)

For the first time, the functions of the company secretary have been specified in the Companies Act. He has to report to the Board about the compliance of the provisions of the Act, rules and other laws applicable to the company. He has also to ensure that the company complies with the Secretarial Standards (as issued by the ICSI and approved by the Central Government) as applicable to the company. Other duties will be prescribed in the Rules to be framed by the Central Government. This provision casts an onerous responsibility on company secretaries in employment in the discharge of their duties and they are expected to exhibit a proactive and responsible role to meet the expectations of the respective companies and regulatory authorities.

The Act also contains some other provisions giving recognition to the profession of company secretaries. They are briefly listed below:

a. **Professional Assistance to Company Liquidator (Section 291)**
With the sanction of the Tribunal, the Company Liquidator may appoint one or more professionals, including company secretaries, to assist him in the performance of his duties and functions under the Act.

b. **Appearance before Tribunal (Section 432)**
A party to any proceedings or appeal before the Tribunal or the Appellate Tribunal may authorize amongst others, a company secretary, to present the case before the Tribunal or the Appellate Tribunal, as the case may be.

c. **Declaration of Compliance at the time of Incorporation (Section 7)**
A company secretary in practice engaged for the incorporation of a company shall be competent to give a declaration that all requirements of the Act and rules in respect of registration and the matters precedent or incidental thereto have been complied with.

d. **Qualifications of Members of Tribunal (Section 409)**
The constitution of the National Company Law Tribunal offers opportunities to company secretaries in practice to become Technical Members of the Tribunal. Amongst others, a company secretary in practice is eligible to become a Technical Member of National Company Law Tribunal, if he is in practice for at least fifteen years.

e. **Others**
In addition to the areas listed above, company secretaries can also play a key role in the fields of valuation, corporate restructuring, winding up and in certification of areas of compliances specified in the Act.

Duty to report frauds

If during the course of their professional duties, a practising professional has reason to believe that an offence involving fraud is being or has been committed by a company, it is his duty to report the fraud.

Section 143 (12) of the Act provides that notwithstanding anything contained in this section, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within such time and in such manner as may be prescribed. As per section 143 (14), the provision of section 143 shall *mutatis mutandis* apply to a company secretary in practice conducting secretarial audit under section 204.

Conclusion

The Companies Act, 2013 is all set to bring a paradigm shift in the Indian corporate world and widen the horizon of various professionals. It has given due recognition to the profession of company secretaries. Company secretaries will constitute a vital link between the company, its Board of Directors, shareholders, government and other regulatory authorities.

Company secretaries, internal auditors and external auditors are often viewed as traditional gatekeepers within the corporate governance ecosystem. The proper functioning of the corporate sector depends on good corporate governance and good corporate governance depends on company secretaries who, as gate keepers, must serve the interests of the company and the society with honesty and integrity.

Company secretaries must serve the broader interests of the public and contribute to promoting a culture of good governance while they serve the interests of their clients. In this context, gatekeepers in the discharge of their roles and responsibilities must aspire to a higher standard of professionalism beyond fulfilling the requirements of the law and expectations of clients.

The ICSI must nurture its members in terms of capacity building, improved skill sets and continuing education in the new regulatory regime. The regulators, investors and the corporate sector hope that the company secretaries will rise to the occasion, face the challenges in corporate compliance in letter and spirit of the law and usher in new standards in corporate governance and compliance. CS

Company Secretary's Exalted Role

The Companies Bill, 2012 as passed by both the Houses of Parliament and assented as the Companies Act, 2013, at last has conferred the belated recognition to the Company Secretaries in the corporate world and reinforced the adage that a Company Secretary is not a luxury but a necessity.

The Origin

The Ministry of Corporate Affairs deserves accolades for ushering a new Companies Act, replacing the moribund Act of 1956, and encompassing a comprehensive Corporate Governance model. While there are several revolutionary and innovative provisions in keeping with the globalized economy, the position of Company Secretary has been elevated to an enhanced pedestal by not only emphasizing his traditionally acknowledged role as a PRINCIPAL OFFICER, but endowing him with the responsibility of widened COMPLIANCE functions. The growing significance of compliance functions arising out of the Enron, WorldCom and Satyam scams has created a new awakening in the corporate world, and it is a tribute to the profession that Company Secretaries have been entrusted with the task to handle this emerging responsibility.

Elevation of the Position of Company Secretary

The journey of the Company Secretary has been a long and arduous one. The Companies Act 1956 defined in Section 2(45) 'Secretary' as an individual to perform the duties of a secretary and any other purely ministerial or administrative duties. The Companies Act, 2013 under section 203(1) has accorded an exalted status to the Company Secretary

bracketing him as a key managerial person along with the Managing Director/CEO. Company Secretary's appointment under the new Act will be effected only by means of a resolution of the Board of Directors.

Thus the profession of Company Secretaries has climbed the top of the professional ladder in these last 57 years, a situation never contemplated by the Founding fathers. Far from being dubbed as a subordinate officer, he is now elevated as a key managerial personnel, superseding his recognized role as a Principal Officer. In the early nineteenth century the functions of the company secretary as contemplated by the Acts were administrative and not managerial, and the secretary should not assume an executive or managerial power in the absence of express authority. Lord Esher, M.R. in *Barnett* v. *South London Tramways Co.* (1887) 18 Q.B.D. 815 held the view that a Secretary is a mere servant. Even in 1928 the House of Lords in *J.C. Houghton and Company* v. *Nothard, Lowe and Wells Ltd* (1928) L.R. (A.C.) 1 reaffirmed the earlier view that as an arrangement which was entered into by the company was not ratified by the company through its Board, it was not authorized by the respondent company.

From 1887 to 1906 Courts had uniformly taken the view that a company secretary fulfils a very humble role and had no authority to make any contract on behalf of the company. A striking departure was made in *Panorama Developments (Guildford) Ltd* v. *Fidelis Furnishing* (1971) when Lord Denning and Lord Justice Salmon enhanced the company secretary's status by stating thus: "Times have changed; a company secretary is a much more important person nowadays than he was in 1887. He is an officer of the company with extensive duties and responsibilities. He is no longer a mere clerk…He is certainly entitled to sign contracts in the administrative side of the Company's affairs…"

Lord Salmon after caricaturing in similar terms the office of secretary stated that "the secretary is the chief administrative officer of the company".

A further recognition of the position of the Secretary came in the Supreme Court's decision in *Turner Morison* v. *Hungerford Investment Trust,* AIR 1972 SC. In this case the secretary was held responsible for all the costs of a litigation in which he had signed the plaint.

Reasons for the Transformation

There are several reasons for this change in the status of company secretaries. Firstly, the major impetus for economic development in the less developed countries came at a time when large scale changes in technology were already under way. The main thrust of economic development came from Companies which were not only able to exploit the new technology but were managed by groups of men well versed in the associated industrial technologies. The Company Secretaries in large companies took on gradually the functions of coordinators of the multitudinous subordinate executive decisions. Secondly the rapid change in the character of social and economic policy aligned with the policy of economic development in our country has cast additional responsibilities on the corporate sector. Company Secretaries thus have to pay due regard to the impact of multiple factors on the internal administration of these companies.

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Emergence of the ICSI

The need for developing the profession of company secretaries was widely recognized in the country culminating in the Government of India setting up in 1960 an Advisory Board to evolve and implement a Government Diploma in Company Secretaryship. The Advisory Board comprised of eminent experienced Company Secretaries from leading Business Houses in India. They formulated the syllabus for the company secretary examinations to be conducted for the first time in India, and the successful candidates were awarded Government Diploma in Company Secretaryship (GDCS). The first such examination was conducted in 1961. It was this essential groundwork in the early sixties that provided the necessary foundation for the present fledgling Institute of Company Secretaries of India. When the nucleus of GDCS Members were available during the period of 8 years, the Government set up on 4 October 1968 the Institute of Company Secretaries of India as a Section 25 Company. The Institute so set up assumed control of all the functions which the Government was carrying out for conducting the examinations for Company Secretaries. As this form was temporary in character, in line with the status of the other two professional institutes namely ICAI and ICWAI, the Government converted the Institute as a Statutory Institute in 1980 under an Act of Parliament.

Statutory Recognition

Even prior to the conversion of the Institute as a Statutory body in 1980, the Government held the baby in its cradle and issued instructions to all Ministries/Departments in the Central

Government to appoint GDCS holders as Company Secretaries in all the Public Enterprises. This was a major thrust and initiative in positioning indigenous company secretaries in the Public Sector in India. This led to the insertion of Section 383A in the Companies Act by the Amendment Act of 1975 providing for mandatory appointment of Company Secretaries in companies having a paid up capital of Rs 25 lakhs and above.

With corporate governance gaining ascendancy all over the world following a series of corporate frauds compliance with corporate governance norms have been made mandatory. Renowned Committees such as Cadbury Committee, Sarbanes Oxley Committee, Kumarmangalam Birla Committee, Naresh Chandra Committtee, to name a few, all unanimously advocated stringent corporate governance norms, many of which are now in the new Companies Act, 2013.

Indeed, the Cadbury Committee has eloquently emphasized the significant role of the Company Secretary in company management thus :"The company secretary has a key role in ensuring that board procedures are both followed and regularly reviewed. The Chairman and the board will look to the company secretary for guidance on what their responsibilities are…and how these should be discharged. All directors should have access to the advice and services of the company secretary and should recognize that the chairman is entitled to the strong and positive support of the company secretary in ensuring the effective functioning of the board".

Compliance Certifications

The second innings of the company secretary as a practitioner is the most innovative and pioneering initiative of the profession. The first such, provision in Section 383A of the Companies Act 1956 requiring every company with a paid up capital of less than Rs 5 Cr. but exceeding Rs 10 Cr. was to obtain a certificate from a practicing company secretary on compliance with the provisions of the Companies Act. This has since been enlarged where the practicing company secretary is now authorized to :

1. issue pre-certification of various e-forms/LLP Forms/DIN certification
2. certify compliance with Buy Back of Securities Rules 1999
3. appear before the National Company Law Appellate Tribunal, Company Law Board, Tax Authorities, Reserve Bank of India, Enforcement Directorate, Competition Commission, Export Import Authorities, and SEBI.

These areas have been incorporated in section 204 of the Companies Act, 2013 providing for secretarial audit in companies of a particular size by a company secretary in practice.

SEBI in exercise of its power under Clause 49 of the Stock Exchange Listing Agreement has already gone ahead in stipulating several of the unanimous recommendations of the above Committees. The stringent compliance norms and penalties for failure to comply have cast additional responsibility on the Company Secretaries, with the result that the Practicing Company Secretaries have now established themselves as an important aid for CG compliance. The Act under section 204 is mandating all listed and other companies of a particular size to annex to their Board Report, a secretarial audit report from a practicing company Secretary. In doing so, India has outperformed all other countries in the world and would be the first country in the world to introduce Secretarial Audit, a concept alien to the rest of the world.

The new Act further specifies under section 205 the functions of the Company Secretaries.

Positioning as Key Managerial Personnel

It must thus be acknowledged that the new Act seeks to strengthen the position of the Company Secretary, and according him the status of a Key Managerial Personnel is the icing on the cake. The Secretary for a long time has been the Cinderella of the corporate scene. The specialization of a Company Secretary is now unique because it now not only fits him in the generalist role which will enable him to take into account all segments of a Company's business, but also makes him directly responsible to administer the various corporate laws. He is not merely to ensure compliance but also assist the Management in taking a total view of all the issues that arise in a Company.

Cinderella has at last been liberated. Fortunately the Companies Act, 2013 at last has conferred the belated recognition to the Company Secretaries in the corporate world and reinforces the adage that a Company Secretary is not a luxury but a necessity. CS

The Companies Act: New definition of 'subsidiary company'

The main problem with the new definition of the term 'subsidiary company' is section 2(87) (ii), according to which if one company "exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies", the other company will be treated as the former's subsidiary. The shortcomings in the new definition are outlined here.

DEFINITION IN THE COMPANIES ACT, 2013

Section 2(87) of the Companies Act, 2013 which defines the expression "subsidiary company" reads thus:

"subsidiary company" or "subsidiary", in relation to any other company (that is to say the holding company), means a company in which the holding company—

(i) controls the composition of the Board of Directors; or

(ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.

Explanation.—For the purposes of this clause,—

(a) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;

(b) the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;

(c) the expression "company" includes any body corporate;

(d) "layer" in relation to a holding company means its subsidiary or subsidiaries.

Anomalies and absurdities

The main problem with the new definition is section 2(87) (ii), according to which if one company "exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies", the other company will be treated as the former's subsidiary.

Firstly, the construction is grammatically wrong. While control of share capital is the correct construction, exercise of share capital is wrong. The word "exercise" is often used in relation to voting power. It is absurd to say that one company exercises more than half of the total share capital of the other company. Therefore, "exercises more than half of the voting power" should have been provided.

One of the principal rules of statutory interpretation is 'the literal rule', i.e. words that are reasonably capable of only one meaning must be given that meaning whatever the result. Secondly, it is

against the principles of statutory interpretation to insert any words in a statute. "It is a corollary to the general rule of literal construction that nothing is to be added to or taken out from a statute unless there are adequate grounds to justify the inference the legislature intended something which it omitted to express.[1] Long ago an English Judge had said: "If the words of the statute are in themselves precise and unambiguous, then no more can be necessary than to expound those words in their natural and ordinary sense. The words themselves do alone in such cases best declare the intent of the law giver."[2]

"If the words used are capable of one construction only then it would not be open to the Courts to adopt any other hypothetical construction on the ground that such construction is more consistent with the alleged object and policy of the Act".[3]

It is contrary to all rules of construction to read words into an Act unless it is absolutely necessary to do so." Section 7 of the Arbitration and Conciliation Act 1996 requires an arbitration agreement to be "signed" by both parties. The Supreme Court refused to read in the words "signed on each page and stamped."[4] The judge may read in or read out words which he considers to be necessarily implied or surplus by words which are already in the statute; and the judge has a limited power to add to, alter or ignore statutory words in order to prevent a provision from being unintelligible, absurd or totally unreasonable, unworkable, or totally irreconcilable with the rest of the statute. In *Becke* v. *Smith*[5] it was held: 'It is a very useful rule, in the construction of a statute, to adhere to the ordinary meaning of the words used, and to the grammatical construction, unless that is at variance with the intention of the legislature, to be collected from the statute itself, or leads to any manifest absurdity or repugnance, in which case the language may be varied or modified, so as to avoid such inconvenience, but no further.'"We cannot aid the Legislature's defective phrasing of an Act, we cannot add and mend, and, by construction, make up deficiencies which are left there."[6]

Going by the abovementioned rules of interpretation, it would seem that the words "exercises or" are inapposite surplusage and should be ignored. The court is unlikely to add the words "one-half of the total voting power" rather than ignoring the words "exercises or".

Secondly, the expression "total share capital" is not defined and hence both equity and preference share capital should be taken into account. According to the definition in the 1956 Act, only when one company holds more than half in nominal value of its equity share capital of another company, that other company is treated as subsidiary of the former. Since preference shares do not have any voting power unless they acquire voting power due to non-payment of dividend for the period specified in the law, it is absurd to include preference share in the concept of 'control' or exercise of voting power. Nowhere in the world non-voting preference shares are included in the definition of 'exercise or control of voting power'. Had the new provision provided for exercise or control of more than half of the total voting power, this problem could have been avoided.

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Thirdly, it is not clear as to whether "total share capital" should be taken as nominal capital or paid-up capital. In the current definition it is clearly stated that a holding should hold more than half in nominal value of equity share capital of the subsidiary.

Section 2(87) (ii) contemplates exercise or control of more than one-half of the total share capital either at its own[7] or together with one or more of its subsidiary companies. The effect of this provision is that if A Ltd and its subsidiary B Ltd hold together more than 50% of the share capital of C Ltd, C Ltd will be treated as a subsidiary of A Ltd. This clause reproduces though in a different language, the provision in section 3(b)(ii) of the current section 4 and its effect is that if B Ltd is a subsidiary of A Ltd and both together hold more than 50% of the share capital of C Ltd, C Ltd will be a subsidiary of A Ltd.

Moreover, according to clause (a) of the Explanation, a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company.

Indian company as subsidiary of foreign company

Clause (c) of the Explanation provides that the expression "company" includes any body corporate. This is identical to what sub-section

1 Maxwell on the Interpretation of Statutes, 12th edition, page 33.
2 Sussex Peerage case (1844) 11 Cl&F 85.
3 *Kanailal Sur* v. *Paramnidhi Sadhu Khan* AIR 1957 SC 907, p. 910, per Gajendragadkar J.
4 *Great Offshore Ltd* v. *Iranian Offshore Engineering & Construction Company* AIR SCW 2008 2722.
5 (1836) 2 M & W 191.
6 The judicial committee in *Crawford* v. *Spooner* (1846) 6 Moore PC 1.
7 The correct phrase is "on its own".

(5) of section 4 provides. Essentially, the companies contemplated in section 4 as holding company and subsidiary company are companies incorporated under the 1956 Act (or any of its predecessors), for in both the expressions the term 'company' occurs. A body becomes a 'company' for the purposes and under the 1956 Act, only if it satisfies the definition given in section 3 of the 1956 Act. Broadly speaking, a body formed and registered as a company under the 1956 Act or any of its predecessors [mentioned in section 3(1)(ii)], is a 'company'. Hence, a company formed and registered outside India is not a 'company' under and for the purposes of the 1956 Act. It may be a 'body corporate', but not a 'company' as defined in section 3.

But sub-section (5) of section 4 contains a crucial provision. It, *inter alia*, provides: "In this section, the expression "company" includes any body corporate". Thus, for the purposes of section 4, a body corporate, which is not a company, is treated as a company, though it is not a company as defined in section 3. The expression 'body corporate', as defined in section 2(7), is of wide connotation. It includes a company incorporated in India as well as a company incorporated outside India. The effect of this provision is that a company (or other body corporate) incorporated outside India will be a body corporate under the 1956 Act and hence a holding company or a subsidiary company in relation to a company incorporated in India under the 1956 Act (or any of its predecessors).

Omission of sub-section (7) of section 4

The new definition does not contain a provision similar to that in section 7(4) of the existing Act. The effect of this sub-section is that, a private company incorporated in India which is a subsidiary of a body corporate incorporated outside India, will get rated as a private company if the entire share capital in the private company is not held by that body corporate (whether alone or together with one or more other bodies corporate incorporated outside India) and that body/ bodies corporate is/are a public company/public companies, as defined in section 3(1)(iv) of the Act, if it was incorporated in India.

The omission of this subsection is likely to give rise to controversy as to whether an Indian private company which is a subsidiary of a foreign company (body corporate) would be treated as a subsidiary of a private company or of a public company, because a foreign company (which is a body corporate) is a 'company' only for the purposes of the definition of 'subsidiary' in section 2(87) of the Companies Act and not for the purposes of the definition of 'company' or the definitions of 'private company' and 'public company'. Therefore, the definitions of 'company', 'private company' and 'public company' given in the Indian Companies Act cannot determine the status of a foreign company (whether it is a private company or a public company) under the Indian Act. As a result, it cannot be said that if a foreign company would be a public company if it has been incorporated in India (which subsection (7) seeks to clarify by a legal fiction).

According to section 2(71) of the new Act, "public company" means

a company which is not a private company; Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles. Thus, a private company in India which is a subsidiary of a public company will be treated as a public company.

As a result, the question as to whether a company incorporated outside India (which is a body corporate under the Indian Act) should be treated as a public company or a private company and how this should be determined, is a question that is going to create controversies. And it cannot be said that all foreign companies having subsidiaries in India should be treated as either public companies or private companies.

There should have been either an incorporation of the contents of sub-section (7) or some other explanatory provision in the new definition clarifying as to what would be the status of a foreign company whether a public or a private company and how it would be determined. This is what sub-section (7) seeks to do and it helps to avoid the confusion pointed out above.

Layers of subsidiaries- why is it sinful?

The new definition provides that "such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed." The term 'layer' is defined as (relation to a holding company) a subsidiary or subsidiaries. Though not clear, it appears that the Central Government will by notification prohibit a chain of subsidiaries (also known as 'step-down subsidiaries') in the case of a certain classes of companies. The intention of this provision is not known since the Notes on Clauses do not throw any light on this. While constitutional validity of this prohibition is questionable, there doesn't seem to be a justification in the current era of global business environment and is therefore a retrograde step. Sometimes it is expedient to invest in a subsidiary through a subsidiary while sometimes it becomes also necessary by virtue of laws of foreign countries to invest in a local subsidiary. CS

Offences, Prosecution and Penalties under the Companies Act, 2013: An Analysis

The provisions of the Companies Act, 2013 relating to offences, penalties and prosecution are refreshingly different from the existing provisions. The Act testifies the fact that it is a re-codification in the real sense of the term and aims to serve the corporates with greater freedom but with severe consequences for non compliance. Public interest is also sought to be protected adequately.

INTRODUCTION

The efficacy of any statute depends upon the readiness with which the laws are enforced by punishing those who violate the law. Needless to say that laws provide regulatory mechanism to ensure that the activities, be it economic or social, are carried on in an orderly manner for the benefit of the country and its people. Non compliance of law by any section of society will have deleterious effect on the economy, particularly in the case of economic legislations like the company law, FEMA, Income tax Act etc. In order to check such tendencies, penal provisions form an integral part of any statute and they are administered by the courts, tribunals etc. The more serious offences are considered as criminal offences which, on conviction, will result in either imprisonment for a definite term or fine or both. Such offences are indulged in by some sections of our society. Hence prosecution of such offenders require greater degree of skill and preparation without which the offenders will go scot free from the clutches of law.

Penal provisions under the Companies Act, 1956

The offences under the Act are criminal offences and are dealt with as such. There is no structured mechanism for dealing with such offences, both serious and non serious. This has been remedied under the Companies Act, 2013 (the new Act) in a most satisfactory manner. The Statement of Objects and Reasons appended to the Bill, *inter alia*, provides for minimum and maximum quantum of penalties for each offence with a suitable deterrence for repeated defaults. The company is identified as a separate entity for imposition of penalties apart from the offenders. In case of fraudulent activities, provision for recovery and disgorgement of asset has been provided. Levy of additional fee in a non-discretionary manner for procedural non compliance, such as late filing of statutory documents will be provided through Rules to be prescribed.

Offences under the new Act

The following are the broad categories of offences recognised and enforced under the new Act;

Offences by the officers who are in default [Section 2(60)]
There is a broad classification of managerial personnel who are liable for penalty or punishment by way of imprisonment, fine or otherwise. They are (i) whole-time directors,(ii) key managerial personnel(KMP),that is, the CEO, or the managing director or the manager, the Company Secretary, the Chief Financial officer and such other directors as specified by the board in the absence of KMP and charged with the responsibility of having

to comply with the legal requirement, deemed director, that is, any person whose advise is acted upon by the board, every director who is aware of contravention of law by virtue of receipt of board proceedings or participation therein without raising any objection or where contravention has taken place with his consent or connivance and in respect of issue or transfer of shares of a company, share transfer agents, registrars and merchant bankers to the issue or transfer.

There are a number of provisions in the new Act which specify the "officer who is in default" as persons responsible for non compliance of law, whether they are privy to the offence or not. These offences are decided either by the adjudicating officer by imposing fine and where penalty involves imprisonment and fine, it will be decided by the Special Court.

Investigation of Offences by Serious Fraud Investigation office (SFIO)

Section 212 provides for investigation into the serious offences by a company on the basis of (i) a report by the Registrar or Inspector under section 208, (ii) special resolution passed by a company that its affairs have to be investigated,(iii) in public interest or (iv) on request from any department of the Central or State Governments.

SFIO set up by the Central Govt. is headed by a Director and consists of such number of experts from (i) banking, (ii) corporate affairs, (iii) taxation, (iv) forensic audit, (v) capital market, (vi) information technology, (vii) law, or (viii) such other fields as may be prescribed, appointed by the Central Govt. from amongst persons of ability, integrity and experience. This is a highly structured organisation and fully equipped to undertake investigation into serious offences. It is` recognised that efficacy of prosecution depends upon completeness of investigation, more so when public interest is involved.

The offences covered (most of which are cognizable in nature) are (i) furnishing of any false or incorrect particulars or suppression of material particulars either before or after incorporation of a company [Section 7(5)&(6)],(ii) criminal liability for mis-statement in prospectus[Section 34], (iii) fraudulently inducing persons to invest money [Section 36], (iv) personation for acquisition of securities [Section 38], (v) issue of duplicate share certificate with intent to defraud [Section 46(5)], (vi) transfer of shares by the depository or participant with a view to defraud a person [Section 56(6)], (vii) concealment and mis-representation in respect of reduction of share capital [Section 140(5)], (viii) failure to furnish information called by the registrar or where the business of the company is being carried on for a fraudulent or unlawful purpose[Section 206], (ix) furnishing false statement, mutilation, destruction of documents {Section 229], (x) fraudulent application for removal of names of companies from the register[Section 251(1)], (xi) fraudulent conduct of business[Section 339(3)] and (xii) furnishing false statement [Section 448].

There are a number of provisions in the new Act which specify the "officer who is in default" as persons responsible for non compliance of law, whether they are privy to the offence or not. These offences are decided either by the adjudicating officer by imposing fine and where penalty involves imprisonment and fine, it will be decided by the Special Court.

Offences involving fraud

The above offences are covered by the term "fraud" which includes in relation to a company, any act, omission, concealment of any fact or abuse of position committed by any person with the connivance in any manner 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. On the other hand, wrongful loss means the loss by unlawful means of property to which the person losing is legally entitled (Section 447).

Grant of Bail

The above offences are cognizable and no person accused of it should be released on bail or on his own bond, unless the Public prosecutor is given an opportunity to oppose the application for such release. In such an event, the court should be satisfied that there are reasonable grounds for believing that he is not guilty of such an offence and that he is not likely to commit any offence while on bail. However, a person who is under the age of sixteen years or is a woman or sick or infirm person may be released on bail. The limitation aforesaid on grant of bail is in addition to the limitation under the Cr .P.C or under any other law for the time being in force.

Cognizance of offence

The Special Court is prohibited from taking cognizance of the aforesaid offences except upon a complaint in writing made by the (i) Director of SFIO or (ii) any officer of the Central Govt authorised by a general or special order in writing. The officers aforesaid should have in their possession material which makes them believe(the reason for such belief should be recorded) that any person has been guilty of the offence aforesaid. Such person should be arrested and he should be informed of the ground of such arrest. The person so arrested

should be taken to the jurisdictional Judicial or Metropolitan Magistrate within 24 hours of arrest excluding the journey time from the place of arrest.

If so directed by the Central Govt, SFIO should submit an interim report on the investigation to the Central Govt. On completion of investigation, SFIO should submit to the Central Govt the investigation report. A copy of such report may be obtained by any person concerned by making an application to the court. On scrutiny of the report, the Central Govt may direct the SFIO to initiate prosecution against the company and its officers or employees who are connected with the affairs of the company, by filing the investigation report with the Special Court for framing of charges. The report so filed shall be deemed to be a report filed by a police officer under section 173 of the Cr.P.C.

Any investigation by SFIO or any other action taken under the Companies Act,1956 should continue to be processed under that Act as if the said Act had not been repealed. Where SFIO is investigating any offence under the new Act, any other investigating agency, State Govt, Police, Income tax, having information or documents in respect of such offence should provide all such information or documents to the SFIO. Similarly SFIO may also share the information with it to the authorities aforesaid.

Investigation into the affairs of the company in other cases (Section 213)

Sections 213 to 218 prescribe detailed procedure for investigation into the affairs of a company taking care to see that the investigating agency has full powers to conduct a proper inquiry. These are enumerated in the following paragraphs.

Eligibility

One hundred members holding not less than one tenth of the total voting power in the case of a company having share capital or not less than one fifth of the persons on the register of members in the case of a company having no share capital and supported by the evidence that they have reason for conducting investigation into the affairs of a company or on the basis of an application made by any other person(this may be by non-members) that circumstances exist suggesting that the (i) business of the company is being conducted to defraud the creditors, members or for a fraudulent or unlawful purpose or in any manner oppressive of its members or that company was formed for any fraudulent or unlawful purpose, (ii) the persons connected with the formation of a company or management of its affairs are guilty of fraud, misfeasance or other mis-conduct towards the company or its members, (iii) the members of the company have not been given all the information with respect to its affairs including calculation of commission payable to a managing or other director or the manager of the company, then the Central Govt, after giving a reasonable opportunity of being heard, that the affairs of the company ought to be investigated by an Inspector, shall appoint one or more competent persons as Inspectors to investigate into the affairs of a company in respect of such matters and report thereon to the Central Govt. Only an individual and not a firm or body corporate can be appointed as Inspectors.

Result of Investigation

After investigation by the Inspector, if it is proved that the business of the company is being conducted in the manner aforesaid, then every officer of the company who is in default or the persons connected with the formation of the company or management of its affairs are punishable for fraud in the manner prescribed by section 447.

Security Deposit

Where the Central Govt has ordered investigation into the affairs of a company or in pursuance of an order made by the Tribunal, the Central Govt may, before appointing an Inspector, require the applicant to give security deposit not exceeding Rs25,000 as it may think fit, for payment of costs and expenses of investigation. Such security deposit will be refunded to the applicant if the investigation results in prosecution(section 214).

Investigation into the ownership of a company

If the Central Govt is of the opinion that it has reason to do so, may appoint one or more Inspectors to investigate and report on matters relating to the company and its membership for the purpose determining the true persons who are financially interested in the success or failure of the company, whether real or apparent or who have controlling or material influence on the policy of the company. Such an appointment may also be made, if the Tribunal during its proceedings, direct that the membership of the company have to be investigated. While appointing an Inspector, the Central Govt may define the scope of investigation, the matters and the period to which it should extend and may also limit the investigation to matters connected with particular shares or debentures. The scope of investigation may also extend to inquiring into the existence of any arrangement or understanding, whether observed or likely to be observed in practice and which is relevant for the purpose of investigation.

Powers of the Inspector

The Inspector has the power to direct a company to preserve and produce to an Inspector or any person authorised by him all books and papers relating to the company or other body corporate as may be required. The Inspector may require any other body corporate to furnish such information or such books and papers to him, if they are relevant for the purpose of investigation. The Inspector should not keep in his custody the books and papers for more than 180 days and he should return the same to the company. He may again requisition the books and papers of the company, if so required for further investigation.

An Inspector may examine on oath any of the officers and employees of the company under investigation including former officers and employees of such company. He may also examine any other person with the prior approval of the Central Govt. In the case of investigation by SFIO, the Inspector requires the approval of the Director of SFIO.

The Inspector being an officer of the Central Govt has the power of a civil court under C.P.C regarding discovery and production of books of accounts and other documents, summoning and enforcing the attendance of persons and examining them on oath, inspection of any books, registers etc. Disobedience of orders of the Inspector by any director or the officer is punishable with imprisonment extending to one year and with fine of Rs 5,000 but it may extend to rupees one lakh.

If a director or any officer is convicted of an offence under this section, they shall be deemed to have vacated their office and they are also disqualified from holding any office in the company.

The officers of the Central Govt, State Govt, Police or statutory authority are required to assist the Inspector for the purpose of Inspection, inquiry or investigation, with the prior approval of the Central Govt.

The Central Govt may enter into an agreement with the Govt of a foreign state on reciprocal basis for the purpose of extending assistance for any inspection, inquiry or investigation, subject to the corresponding law in that state.

If in the course of investigation an application is made to the competent court in India by an Inspector about the existence of an evidence in a country or place outside India, the court may issue a letter of request to a court or authority outside India which may be forwarded by the Central Govt. This will enable the Inspector to examine the person orally who is acquainted with the facts and circumstances of the case, record the statement of such person and forward copies of such evidence to the court in India. All such statement or document are deemed to be evidence collected during the course of investigation.

If so required and the Inspector considers expedient to investigate into the affairs of a related company, he may do so (i) in regard to that company's subsidiary or holding company or its subsidiary,(ii) any other body corporate which is managed by any person as managing director or manager at the relevant time,(iii) any other body corporate whose board consists of nominees of such company or accustomed to act in accordance with the directions or instructions of any such company or any of its directors,(iv) the inspector may also examine any person who at the relevant point of time was the company's managing director or manager or employee with the prior approval of the Central Govt.

If the Inspector has reason to believe that the books & papers relating to a company are likely to be destroyed, mutilated, altered, falsified, he may enter the premises of such company to seize the same required by him or take copies thereof. The limitation is that the Inspector should return the seized books and papers not later than the conclusion of the investigation. The provisions of the Cr.P.C. will apply in respect of search and seizure.

The Tribunal may issue an order freezing the assets of the company, if there is a reasonable ground to believe that the transfer, disposal of funds, assets are likely to take place which is prejudicial to the interests of the company or its shareholders or creditors or in public interest. In case of default the company is punishable with fine of not less than one lakh of rupees but it may extend to Rs 25 lakhs.

If the Tribunal is of the opinion that it has reason to believe that the facts about the securities issued or to be issued by a company cannot be found unless restrictions are placed, it may by order direct that the securities shall be subject to such restrictions as it may deem fit.

The Inspector, if so directed by the Central Govt, shall submit an interim report and on conclusion of the investigation, the final report to the Central Govt. A copy of the report may be obtained by making an application to the Central Govt. The Central Govt may prosecute the company and others that an offence has been committed which is criminally triable.

Mediation and Conciliation of Disputes (Section 442)

Any of the parties to the proceedings may, at any time, during the course of such proceedings before the Central Govt, the

The offences under this Act are triable by the Special Court for the area in which the registered office of the company is situate and in relation to which the offence is committed. Where there are more than one Special court for such area, the High Court shall specify one of them for the purpose of trial.

Tribunal, or the Appellate tribunal, apply to these authorities in such form and with such fee as may be prescribed for referring the matter pertaining to such proceedings to the Mediation and Conciliation panel in which case the Central Govt, the Tribunal or the Appellate Tribunal shall appoint one or more experts from the panel maintained by it. It is also provided that the Central Govt should maintain a panel of experts to be called as Mediation & Conciliation panel, consisting such number of experts having such qualification as may be prescribed for mediation between the parties during the pendency of any such proceeding before the Central Govt, or the Tribunal or the Appellate Tribunal under this Act.

Appointment of Company Prosecutors (Sections 443 - 446)

The Central Govt may appoint generally or for any specified class of cases in any local area, one or more persons as Company Prosecutors for the conduct of prosecution arising out of this Act and persons so appointed shall have all the powers and privileges conferred by the Code on Public prosecutors appointed under section 24 of the Code.

The Central govt may, in any case arising out of the new Act, direct any Company Prosecutor or authorise any other person to present an appeal from an order, other than High Court, and the appeal presented by such Prosecutor or other person shall be deemed to have been validly presented to the appellate court.

The provisions of section 250 of the Cr.P.C. shall apply, *mutatis mutandis,* to compensation for accusation without reasonable cause before the Special Court or the Court of Sessions. The court imposing any fine may direct that the whole or any part thereof shall be applied in or towards payment of costs of the proceedings or in or towards payment of reward to the person on whose intimation the proceedings were instituted.

Establishment of Special Court (Sections 435 to 440)

Another novel feature of the Act is the establishment of Special Courts for providing speedy trial of offences under this Act. The Central Govt may, by notification, establish or designate as many Special Courts as may be necessary. Such a court shall consist of single judge appointed by the Central Govt with the concurrence of the Chief Justice of the High Court within whose jurisdiction the Judge to be appointed is working. A person is not qualified to be appointed as aforesaid, unless he is, immediately before such appointment, holding office of a Session Judge or Additional Sessions Judge, as such judges alone can impose punishment by way of imprisonment authorised by law, as per section 28 of the Cr. P.C.

The offences under this Act are triable by the Special Court for the area in which the registered office of the company is situate and in relation to which the offence is committed. Where there are more than one Special court for such area, the High Court shall specify one of them for the purpose of trial.

Where a person accused of an offence is forwarded to a Magistrate, such Magistrate may authorise the detention of such person in such manner as he thinks fit for a period not exceeding 15 days in the whole, where the Magistrate is a judicial Magistrate. The period of detention shall not be more than 7 days, if the Magistrate is an Executive Magistrate. Where detention is not considered necessary, either upon or before the expiry of the period of detention, such person may be forwarded to the Special Court having jurisdiction. The Court, upon perusal of the police report, may take cognizance of the offence without the accused being committed to it for trial. It may also try an offence under the Cr.P.C. other than an offence under this Act.

The Special Court, if it thinks fit, can try an offence in a summary manner in the case of an offence (not involving punishment of imprisonment for a term exceeding three years) in which case no sentence of imprisonment for a term exceeding one year shall be passed. However, during the summary trial, if it appears to the Special Court that imprisonment for term exceeding one year may have to be passed or otherwise, it may after hearing the parties, record an order to that effect and thereafter recall any witnesses who may have been examined and proceed to re-hear the case as a regular trial.

The High Court has all the powers conferred by Chapters XXIX and XXX of the Cr P.C. as if the Special Court were a court of Sessions trying cases within the local limits of jurisdiction of the High Court.

The provisions of the Cr.P.C. shall apply to the proceedings

before a Special Court and the said court is deemed to be a Court of Sessions and the person conducting the prosecution before such court shall be deemed to be a Public prosecutor. (Section 438).

Every offence under this Act (except the offences involving investigation by SFIO) shall be deemed to be non-cognizable within the meaning of the said Code. No court shall take cognizance of an offence alleged to have been conducted by any company or any officer thereof except on a complaint in writing of the Registrar, a shareholder of a company or of any person authorised by the Central Govt. However, in the case of offences relating to issue and transfer of securities, non payment of dividend, cognizance of such offence can be taken by the court on the complaint in writing by a person authorised by SEBI.

Where a complaint is lodged by the Registrar or by a person authorised by the Central Govt, the personal presence of such person before the court shall not be necessary, unless the court requires the presence of such person at the trial.

Transitional Provision(Section 440)

In respect of an offence under this Act which is triable by a Special Court shall, until a Special Court is established, be tried by a Court of sessions exercising the jurisdiction over the area, notwithstanding any thing contained in the Cr.P.C. This shall not affect the powers of the High Court for transfer of cases from a Sessions Court.

Compounding of Offences (Section 441)

This section is a re-enactment of section 621A of the Companies Act,1956 and provides for composition of certain offences involving imposition of fine as punishment. This is a beneficial measure and provides a silver lining for settlement of offences out of court and takes away the need for prosecution by the Central Govt.

Any offence punishable with fine only is compoundable in accordance with the procedure laid down in the new Act, either before or after institution of any prosecution. An offence is compoundable by the Tribunal where the maximum amount of fine which may be imposed does not exceed Rs 5 lakh. The authority to do so is either the Regional Director or any officer authorised by the Central Govt as may be specified. However, the specified sum should not exceed the maximum amount of fine which may be imposed for the offence. Any additional fee already paid is deductible from the sum payable under compounding facility.

There are two exceptions which do not qualify for compounding and they are (i) in the case of a company in respect of which investigation has already been initiated or is pending, (ii) any offence committed by a company or its officers within a period of three years from the date on which a similar offence was compounded. After the expiry of three years such an offence is treated as a fresh offence.

A simplified procedure is laid down for giving effect to the compounding of an offence. Every application is required to be made to the Registrar who shall forward the same, together with his comments, to the Tribunal or the Regional Director as the case may be. Where an offence has been compounded before institution of prosecution, no such prosecution will be instituted. However, where compounding is made after institution of prosecution, such compounding should be brought to the notice of the court by the Registrar in writing. On filing of such notice, the company and its officers shall be discharged from the prosecution. This is subject to the company or its officers filing any document or return as the case may be in fulfilment of legal obligation.

In the case of an offence punishable with imprisonment or fine or with both, compounding may be permitted by the Special Court. However an offence punishable with imprisonment only or with imprisonment and fine is not compoundable, as they are serious offences.

Punishment for Offences (Sections 447 to 453)

Punishment for fraud (Section 447)

Fraud is punishable with imprisonment for a term of not less than six months but it may extend to ten years. The liability towards fine is not less than the amount involved in the fraud but it may extend to three times the amount. Where the fraud involves public interest, the imprisonment shall not be less than three years. This is without prejudice to the repayment of any debt involved in fraud.

Fraud is comprehensively defined to include (i) any act, omission, concealment of any fact or abuse of position committed by any person, with the connivance and with intent to deceive, to gain undue advantage or injure the interests of the company or its shareholders or creditors, (ii) wrongful gain means the gain by unlawful means of property to which the person gaining is not legally entitled, (iii) wrongful loss means the loss by unlawful means of property to which the person losing is legally entitled.

Punishment for false statement (Section 448)

Any person making a statement which is false in any material particular knowing it to be false or omission to make material fact knowing it to be material, in relation to any return, report, certificate, financial statement, prospectus statement or other document required by the provisions of this Act or the rules made there under, the punishment for the same is as applicable for fraud.

Punishment for false evidence (Section 449)

If any person intentionally gives false evidence upon any examination on oath or solemn affirmation authorised under this Act or in any affidavit, deposition or solemn affirmation in or about the winding up of any company, he shall be punishable with imprisonment for a term which shall not be less than three years but it may extend to seven years and with fine which may extend to rupees ten lakh.

Punishment where no specific penalty or punishment is provided (Section 450)

If a company or any officer of the company or any other person contravenes any of the provisions of proposed Act or the rules there under or any condition, limitation, or restriction subject to which any approval is given or granted for which no penalty or punishment is provided elsewhere, then the company and every officer thereof who is in default or such other person is punishable with fine extending it to rupees ten thousand and where the contravention is a continuing offence, with a further fine extending it to rupees one thousand for every day during which the contravention continues.

Punishment in case of repeated default (Section 451)

In the case of repeated default committed for the second or subsequent occasions within a period of three years, the company and every officer thereof who is in default is punishable with twice the amount of fine for such offence, in addition to any imprisonment for the same.

Punishment for wrongfully withholding of property (Section 452)

If any officer or employee of a company wrongfully obtains possession of any property including cash or having such property wrongfully withholding it or knowingly applies it for the purpose other than expressed or directed in the articles and authorised by this Act, then he shall, on the complaint of the company or any member or creditor or contributory there of, be punishable with fine of not less than rupees one lakh but it may extend to rupees five lakh. The court trying an offence may also order restoration of property and in default there of, the person is punishable with imprisonment for a period of two years.

Punishment for improper use of the word "limited" or "private limited"(Section 453)

If any person carries on trade or business under the name or title of which the word "limited" or the words "private limited" or any construction or imitation thereof, unless duly incorporated with limited liability or as a private company with limited liability, as the case may be, is punishable with fine of not less than rupees five hundred but it may extend to rupees two thousand for every day during which that name or title has been used.

Adjudication of Penalties (Section 454)

This is a novel feature. The Central Govt may, by an order published in the Official Gazette, appoint as many officers of the Central Govt, not below the rank of Registrar, as Adjudicating Officers for adjudging penalty under this Act in the prescribed manner. The regulations in this behalf are as under: While appointing adjudicating officers, the Central Govt shall specify the jurisdiction of each of them. The adjudicating officer may, by an order impose the penalty on the company and the officers in default stating the non compliance or default under the relevant provisions of this Act.Before imposing penalty, the adjudicating officer should give a reasonable opportunity of being heard to the company and the officer who is in default. Any person aggrieved by an order made by adjudicating officer may prefer an appeal to the Regional Director having jurisdiction in the matter. Every appeal shall be filed within sixty days from the date of receipt of a copy of the order. The R.D. after giving the parties to the appeal an opportunity of being heard pass such order as he thinks fit confirming, modifying, or setting aside the order appealed against. Where the company does not pay the penalty imposed by A.O. or R.D. within a period of ninety days from the date of receipt of the order, the company is punishable with fine which shall not be less than rupees twenty five thousand but it may extend to rupees five lakh. Where an officer of the company who is in default does not pay the penalty within a period of ninety days from the date of receipt of a copy of the order, such officer is punishable with imprisonment for six months or with fine of not less than rupees twenty five thousand but it may extend to rupees one lakh or with both.

Conclusion

The provisions of the new Act are refreshingly different from what is provided for in the Companies Act of 1956, both structurally and otherwise. The new Act testifies to the fact that it is a re-codification in the real sense of the terms and aims to serve the corporates with greater freedom but with severe punishment for non compliance. The public interest is also sought to be protected adequately. CS

Independent Directors

Role and Responsibilities under the Companies Act, 2013

With a view to ensure better corporate governance the Stock Exchange Listing Agreement requires the appointment of independent directors on the boards of listed companies. Going further the Companies Act, 2013 has made it mandatory for companies to appoint independent directors and has also prescribed the requisite qualifications. This article elaborately explains the implications of the new provisions relating to independent directors.

Every problem has a solution or so it is believed. Therefore, efforts are always on to find solutions to the various intractable problems faced by the world from time to time. However, the million dollar question is of finding the perfect solution to the problem on hand. This is easier said than done, but the quest to find the right answer continues. Today the corporate sector constitutes the backbone of the economy. With huge public funds riding on its back and involving the interests of multiple stakeholders, directly and indirectly, the corporate sector carries a huge responsibility on its shoulders. Whether the corporate sector will discharge its obligations effectively is an issue that has been engaging the best of minds in India and abroad.

Background

During the last decade, Corporate Governance has become one of the most widely discussed topics in the business world, in India as also in countries like the United States of America and United Kingdom. As stated by the Narayanamurthy Committee Report, "Corporate Governance is about ethical conduct in business. The Corporate Governance is beyond the realm of law. It stems from the culture and mindset of management and cannot be

While there can be no denying the fact that the expertise and experience of an independent director would prove immensely useful to the company on whose board he is a director, he also has to be the conscience keeper of the stakeholders by ensuring that the decisions taken by the board are in the larger interest of the company and not merely in the interest of the promoter group.

regulated by legislation alone". As Martin Luther King, Jr. once remarked "Morality cannot be legislated, but behaviour can be regulated. Judicial decrees may not change the heart, but they can restrain the heartless".While it is recognised that ethical Corporate Governance cannot be really enforced by law, it cannot be left totally to the whims and fancies of individual conduct to the detriment of larger interest.

Therefore, continuous efforts are being made to effect changes in the applicable laws so as to improve the standards of Corporate Governance. In a way it can be said that the Companies Act, 1956, was perhaps the first enactment responsible for introducing some form of corporate governance for all types of companies. Similarly, the listing agreement brought in a modicum of corporate governance specifically applicable to listed companies only.

For many years the listing agreement was primarily meant to ensure that every listed company protected the interest of its shareholders by ensuring certain minimum compliances like timely dispatch of share certificates, annual accounts, dividend, etc. At the same time every listed company was under obligation to keep the stock exchanges in the know about any information that could have implications on the financial health of the company.

For the first time, as a result of the Kumar Mangalam Birla Committee Report, the term 'Independent director' became a part of corporate lexicon. To give legal character to the newly introduced concept and to make it compulsory for the listed companies, SEBI effected changes in the listing agreement by introducing a new clause in the form of clause 49, exclusively devoted to Corporate Governance. Clause 49 also prescribes several other requirements, Audit Committee being the most important. The thrust of this article is confined to the role of independent directors in the scheme of corporate governance and more particularly, the provisions contained in the recently passed Companies Act, 2013 (the new Act).

Interestingly, though the concept of independent directors was brought into force so far as listing companies are concerned, no specific definition of the term "independent director" exist in the Companies Act, 1956 (the Act). The Birla Committee put the onus on the management to decide as to whether a particular director was an independent director or not for meeting the requirements as stipulated in clause 49.

Subsequently, the issue of definition of 'independent director' was considered by the Naresh Chandra Committee. The Committee took note of the prevailing scenario in the Indian and the international corporate sector, including the various international definitions of the word 'independence'. After going through the various guidelines and taking cognizance of different factors, the Committee arrived at a definition of independent directors. Even this definition is not specific in nature, but it is more in the nature of a code comprising of seven points. In fact, it would seem that the Committee was unable to define the term 'independent director' and instead it provided an explanation specifying negative covenants / disqualifications, absence of which would qualify a person to become an independent director.

Thereafter, the Committee appointed under the chairmanship of Mr. Narayanamurthy has also given a definition to the term "independent director", which is on the lines of the one given by the Naresh Chandra Committee.

To redress the shortcoming in the Act so far as the subject of independent directors is concerned, the Government has incorporated Section 149 in the new Act that defines the term 'independent director'. Although, in reality, the said section does not define the term 'independent director' it mentions several negative attributes or disqualifications which would render a person incapable of being appointed as an independent director.

Concept of Independent Director

Who is an independent director and what is meant by an independent director? Do we mean a person who is independent of the influence of the promoters and the management or is he a person who does not care about the management and is always in an adversarial roles? Or is he a person of experience and expertise whose wise counsel will be available for the benefit of the company? Well, keeping in view the role and responsibilities an independent director is expected to perform, it would be fair to say that he or she will be an amalgam of all these and much more.

While there can be no denying the fact that the expertise and experience of an independent director would prove immensely useful to the company on whose board he is a director, he also has to be the conscience keeper of the stakeholders by ensuring that the decisions taken by the board are in the larger interest of the company and not merely in the interest of the promoter group.

While performing the role expected of him, there is every possibility that he could fall foul of the promoter group who has the control over the board and in such a situation his mettle will be tested. The law expects him to stand up for what is right in the circumstances; in case it is not possible for him to convince others of his views, it will be his duty to ensure that his dissent is recorded in the minutes of the proceedings of the board meeting.

It is an accepted fact that it is not easy to define an 'independent director', but the new Act has attempted to provide a definition by stipulating for the first time, the qualities and qualifications that a person should have to make that person eligible for appointment as independent director rather than listing the grounds of disqualification as has been the case before.

Section 149(6) of the new Act prescribes several qualifications expected of an independent director in relation to a company. One requisite is that he should be a person of integrity. On first thought it may sound ludicrous that it is necessary to specify that a person wanting to be an independent director should be a man of integrity, because it should be without saying that every person on the board of a company should be a man of integrity. Unfortunately, experience indicates that many directors over the years have failed in discharging their fiduciary duties; perhaps that is why the lawmakers have felt the need to provide in law that such a person should be a man of integrity. However, at the same time it should be noted that ethics and morality cannot be legislated though ethical standards of conduct may be specified by the law. As if the so many qualifications listed in the clause are not enough, the Government has kept for itself the residuary power to prescribe such other qualifications as the Government may deem fit. One can only hope that the additional qualifications that may be prescribed by the Government should not make the task of getting independent directors still more difficult.

The ten requisites mentioned in Section 149(6) of the new Act for eligibility to be an independent director indicates the intent of the Government to ensure that an independent director is not only a capable and experienced person, but he should not have any material pecuniary or other relationship with the company that would come in the way of his discharging his duties without fear or favour.

Role of Independent Directors

In the existing Act there is no provision for appointment of independent directors; it is only the listing agreement which provides for the same. Strictly viewed, under the Act, except for the managing and whole-time directors, all the other directors being non-executive directors, also called ordinary or part-time directors, enjoy similar status and responsibilities. Therefore, one could wonder as to the exact nature of the role to be played by independent directors. One thing that is certain is that the success of the system of corporate governance is directly dependant upon the discharge of duties by the independent directors. Onerous responsibilities have been laid on the shoulders of independent directors and they are expected to play the assigned role effectively.

Schedule IV of the new Act provides a comprehensive code for independent directors covering the following aspects:

I. Guidelines of professional conduct: An independent director is required to uphold ethical standards of integrity and probity and work objectively and constructively while exercising his duties. He is expected to act in a bona fide manner in the interest of the company and devote sufficient time and attention to his professional obligations for informed and balanced decision making. At the same time he should not abuse his position and must refrain from any action that would lead to loss of his independence. He is under an obligation to assist the company in implementing the best corporate governance practices.

II. Role and functions: The role that he has to play includes bringing an independent judgment to bear on the Board's deliberations especially on issues of strategy, performance, risk management, resources, key appointments and standards of conduct. In addition, he is also expected to bring an objective view in the evaluation of the performance of the board and the management. He has to scrutinize the performance of the management in meeting agreed goals and monitor the reporting of performance and ensure the integrity of financial information, financial controls and the systems of risk management. He has a role to play while fixing the remuneration of executive directors and key managerial personnel and plays a prime role in appointment and removal of executive directors, key managerial personnel and senior management.

III. Duties: The Schedule has stipulated thirteen different duties to be performed by an independent director. Some of the duties include:(1) Regularly updating and refreshing the skills, knowledge and familiarity with the company; (2) Strive to attend

The most revolutionary provision is the one that requires the performance evaluation of independent directors. As of now there is no formal requirement for conducting any evaluation of non-executive directors or independent directors. The evaluation of independent directors has to be done by the entire Board of Directors, excluding the director being evaluated.

and participate actively in all meetings of the Board and the committees and general meetings.(3) Keep well informed about the company and the external environmentin which it operates. Interestingly, the list of duties also stipulates that an independent director should not unfairly obstruct the functioning of a proper Board or committee. He is also expected to pay attention and ensure that adequate deliberations are held before approving related party transactions and assure himself that the same are in the interest of the company. He has to ensure that the company has an adequate and functional vigil mechanism and also has to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use. He cannot disclose confidential information, including commercial secrets, technologies, unpublished price sensitive information, etc., except as required by law.

IV. Manner of appointment: For the first time the law stipulates that a formal letter of appointment has to be given to an independent director mentioning all those items stated in item (4) of this clause in the schedule.

V & VI Re-appointment & Resignation or removal: For the first time the law makes a provision about resignation by a director including an independent director and in the process has removed the prevailing ambiguity in the law.

VII. Separate meetings: An interesting duty that has been cast upon the independent directors is that they will have to hold at least one meeting in a year, without the attendance of non-independent directors and members of management. The objective of such a meeting being to afford an opportunity to the independent directors to review the performance of the company, flow of information from the management to the Board, etc.It is expected that such a meeting must be attended by all the independent directors of the company.

VIII.Evaluation mechanism: The most revolutionary provision is the one that requires the performance evaluation of independent directors. As of now there is no formal requirement for conducting any evaluation of non-executive directors or independent directors. The evaluation of independent directors has to be done by the entire Board of Directors, excluding the director being evaluated. The Board will keep in view the report of performance evaluation while determining the suitability of extending or continuing the term of appointment of the independent director.

A food for thought that arises from the duties cast upon an independent director under the new Act is, whether casting such onerous duties upon the independent directors would act as a deterrent for persons who would like to put themselves up for appointment as independent directors as they would be wary of the enormity of the role being assigned to them under the new law without adequate legal protection.

Appointment and Term

There is a provision in Schedule IV regarding the manner of appointing an independent director, but Section 150 of the new Act stipulates that an independent director has to be selected from a data bank maintained by authorised bodies / institutions. Such bodies / institutions will be notified by the Government. It is only to be hoped that the Government will not have any direct role in the appointment of independent directors. An independent director shall hold office for a term up to five consecutive years on the Board of a company. However, he will be eligible for reappointment on passing of a special resolution by the company; disclosure to that effect has to be made in the Board's report about the intention to re-appoint such independent director.

How much remuneration should be paid to independent directors?

Quality never comes cheap; senior professionals need to be remunerated adequately for the time spent by them for the company, etc. It is true that if the remuneration is too low, very few worthwhile professionals or other capable persons would be willing to spend time on the company boards. At the same time, there is a fear that if the remuneration is too high there is every risk of independence being compromised and defeating the very purpose of appointing an independent director. Hence, it is a classic hen and the egg story. Then there is the question of loss making companies, sick companies, unknown unlisted public companies, etc. Will they be able to afford so many independent directors? And even if they pay adequately, how many persons would be interested in becoming independent directors on the boards of such companies? There is a real need for the authorities to give a proper thought to these issues so that the main objective is not defeated.

Liability of Independent Directors

Independent directors are expected to perform twin functions as members of the board of a company. On the one hand they have

to participate in the proceedings of the board, while at the same time they are expected to perform the oversight function and ensure that all the decisions are taken in the larger interest of all the stakeholders. However, a question that needs to be addressed in this context is about the degree of involvement of an independent director in the affairs of the company and the liability that is fastened on his shoulders. There has been a demand in certain quarters, particularly from the Chambers, that independent directors be given protection from legal proceedings.There is no doubt that an independent director would have limited interaction with a company on whose board he is a director, but in the eyes of law that would not matter. As pointed out by the Naresh Chandra Committee, any infringement by an independent director is treated akin to that by an executive director. The Committee did recommend that independent directors need to be exempted from the applicability of certain laws.

Section 149(8) of the new Act states that the company and independent directors shall abide by the provisions specified in Schedule IV. Section 149(12), *inter-alia*, states that notwithstanding anything contained in this Act an independent director shall be held liable, 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. This in a way limits the scope of offences for which an independent director can be personally held liable. However, it is imperative that independent directors act diligently while discharging their duties and be conscious and cautious when it comes to giving consent to any proposal, else they will have to be prepared to face the consequences of their actions. At the same time, it is evident that by using a phrase like 'attributable through Board processes', law has left room for vagaries of interpretation and consequent uncertainties. It would have been better if the provision was made more specific and direct in nature. Further, although, the law is attempting to limit the scope of offences in respect of independent directors, at the time of prosecution, all directors irrespective of their category are issued summons. It is only after leading evidence that a conclusion is drawn whether the independent director was diligent in the discharge of his duties or not and that whether he had acted in a bona fide manner or not. However, till such a conclusion is drawn, the independent director suffers a lot of inconvenience and embarrassment which is avoidable.

Are Independent directors the panacea for all the corporate ills?

Even if all the listed companies which are required to have independent directors, on their boards have done so, would that automatically result in better Corporate Governance? Will such boards ensure that there would be no recurrence of Harshad Mehta and Ketan Parekh and NSEL scams? Quite unlikely. If legal provisions alone could change the scene, then India should have been miles ahead of all the countries as India is one of the most legislated countries in the world. Therefore, it would be extremely short sighted or even naïve to believe that a mere provision in the law for appointment of directors would achieve miracles. As mentioned earlier, law by itself can only render a limited assistance. Mere provision or even actual appointment of independent directors would not solve all the problems of the corporate sector nor will it mean a quantitative jump in Corporate Governance. Eventually it would depend not only on the quality and calibre of the independent directors but also on the commitment of the managements toward independent directors. Therefore,it is necessary to take a rational and holistic view of the issue rather than believing that independent directors would prove to be a magical wand.

Can the Corporate Sector be insulated?

It would be tempting to believe that all the ills plaguing the corporate sector will vanish if companies have independent directors on their boards as envisaged in the new Act. There is no doubt that the Government has done a commendable job by enacting adequate provisions in the Act specifying the definition, role and responsibilities of independent directors. However, the way the role of independent directors has been advocated during the last decade, it would convey an impression that good corporate governance is self sustaining and once the companies have independent directors on their board then automatically everything will be hunky dory.

The new Act mandates that every listed public company shall have atleast one third of its total number of directors as independent directors. The Central Government will prescribe the minimum number with respect to unlisted public companies. Private companies are not required to have independent directors. However, it is a misnomer to presume that independent directors are the sole answer for corporate governance and that only public companies require corporate governance. All companies, whether public or private, are required to conduct their affairs in a proper and transparent manner. The key to successful corporate governance lies in the commitment of the management of a company to achieve the same.

A question that comes to one's mind in this context is, notwithstanding the best management practices, can companies be insulated from the prevailing economic, political and social environment of the country? Can independent directors help create an island of purity in the midst of a cesspool full of dirt and filth all around? After all, to an extent the practices prevalent in the corporate sector are nothing but the reflection of ethics and morality prevailing in the society. For independent directors to really succeed and make corporate governance what it should be, then apart from the promoters' attitude, there has to be ethical conduct in public life which should be the norm and not an exception. Otherwise we will have the odd lotus surrounded by filth all around us. CS

New Company Legislation – Directors

The provisions of the Companies Act, 2013 relating to the appointment of directors their role, duties, responsibilities, powers and the regulations subject to which they have to perform their duties in a company have been elaborately discussed here.

Companies incorporated under any company legislation obtaining at the time and place of their incorporation are bodies corporate and are artificial persons in the eyes of law. It has of necessity to act through human beings. The general meeting comprising of all members which sets out the overall objectives and policies of a company, is one of the three organs of a company. The Board of Directors, being the second organ of a company, translates the objectives and policies set out by the general meeting into action points for implementation thereof by the third organ namely the employees, of the company. As regards outsiders the Directors of a company are agents of the company but in relation to shareholders of the company they are to some extent trustees of the company to the extent they hold the properties of the company for their benefit. After various attempts, the first of which commenced in the year 1993, the Government achieved success in the year 2013 in legislating a new Companies Act (the Act), which received the assent of the President of India on 29th August 2013 and has been christened as Companies Act, 2013 (18 of 2013). The Act, probably will be put into force early in 2014. It is proposed to discuss in this Article the appointment of directors who constitute the Board of Directors, the second and very important organ of a company, their role in a company, their duties and responsibilities, their powers and the regulations subject to which they have to perform their duties in a company, etc. as stipulated in the new Companies Act.

Number of Directors

Under Section 149 of the Companies Act, 2013, every company is required to have a Board of Directors consisting of individuals as directors. Section 2(10) defines the Board to mean the collective body of directors. It has been stipulated that directors should be individuals, i.e. natural persons. To some extent the office of director, is office of trust and there should be somebody readily available who can be held responsible for the failure to

carry out the trust and it might be difficult to fix the responsibility, if the director was a corporation or an association of persons. [*Oriental Metal Pressing Works (P) Limited* v. *Bhaskar Kasinath Thakoor*, [1961] 31 Comp. Cas 343 (SC)]. Section 149 further stipulates that a public limited company should have a minimum of three directors, a private limited company should have a minimum of two directors, one director in the case of a 'one person company' and a maximum of 15 directors for all the companies. Where necessary, the ceiling on the number of directors could be pierced by passing a special resolution. It should be noted that the aforesaid ceiling of 15 directors would not be a bar for the appointment of Directors by State Financial Corporations, State Bank of India and its subsidiaries, Nationalised Banks and Life Insurance Corporation of India, because the enactment under which or by which they are constituted have overriding effect and confer on the respective institutions this power in spite of provisions to the contrary in any legislation or document. Approval of the Central Government under section 259 of the Companies Act, 1956 (the Current Act) has been dispensed with. Also the said section 149 postulates that a company should have at least one director who has stayed in India for a period of not less than 182 days in the previous calendar year. This requirement has been inserted in the Act keeping in mind the number of companies incorporated in India by companies incorporated abroad which have all directors resident abroad, so as to ensure that a company has at any time a director who is resident in India so that he can be made responsible for any defaults committed by it. This requirement has to be complied with by existing companies existing within one year of the enforcement of the Act. This clause further requires listed companies and such class of companies as may be prescribed to have a woman on their Board.

Appointment of Directors

Directors of companies are appointed by the following:

(a) The promoters
(b) The General Meeting
(c) Small shareholders
(d) The Board of Directors
(e) BIFR
(f) National Company Law Tribunal
(g) Lenders and State Financial Corporations, etc.

The power to appoint directors, of course, with the exception of appointing authorities mentioned in (e) and (f) above has to be spelt out in the Articles of Association. In respect of the authorities mentioned at (g) above, while the foregoing is the general rule, power to appoint directors has been conferred on certain lenders and State Financial corporations, Life Insurance Corporation of India, State Bank of India and its subsidiaries, all Nationalised banks by the enactments by which they are constituted, on the Boards of Companies to which they have extended financial facilities. The said Acts override the position set out above.

Under Section 168(3) of the new Act if all the directors of a company resign or vacate their offices as directors, then the promoters are empowered to appoint the required number of directors who will hold office till directors are elected at the general meeting. No time limit has been stipulated for appointment of directors by general meeting.

The Promoters

Under Section 152 of the new Act, first directors of a company until they are appointed by the general meeting could be named in the Articles of Association. In the absence of any provision relating to the first directors in the Articles, subscribers to the Memorandum of Association who are individuals would be deemed to be the First Directors. The promoters decide the provisions in the Memorandum and Articles and also subscribe to the Memorandum and Articles of Association. Hence it could be said that the promoters have a role in the appointment of first directors.

Under Section 168(3) of the new Act if all the directors of a company resign or vacate their offices as directors, then the promoters are empowered to appoint the required number of directors who will hold office till directors are elected at the general meeting. No time limit has been stipulated for appointment of directors by general meeting. By implication the appointment has to be made sufficiently before the due date of the annual general meeting held first after the resignation or vacation of office as director referred to above so that the company concerned could comply with the requirement of retirement of directors under section 168. The number of directors who could be so appointed should not exceed the effective quorum required for a meeting of the Board. This is a welcome provision which will remove unexpected complications in a company resulting from the resignation or vacation of office, by all directors.

General Meeting

Under Section 152 not less than two-thirds of the total number of directors have to retire by rotation and have to be appointed by the general meeting. In default of any provisions to the contrary the remaining directors and all the directors of a private limited company have also to be appointed by the general meeting. The implication of this requirement is that not more than one-third of the total number of directors in a public limited company and all the directors in a private limited company could, by having suitable provisions in its Articles of Association, be appointed by other interests. The managing director, whole-time director,

independent director, nominee directors of lenders and other institutions could be accommodated within the aforementioned stipulation of "not more than one-third of the total number of directors". As the tenure of appointment of an independent director under section 149 of the new Act is five years he will not be counted as a director liable to retire by rotation for the purposes of ceiling and appointment referred to above.

Small Shareholders

Under Section 151 of the new Act, a listed company may have a director appointed by the small shareholders in such manner and with such terms and conditions as may be prescribed. For this purpose a small shareholder would mean a shareholder holding shares of the nominal value of not more than twenty thousand rupees or such other sum as may be prescribed. The reference is to shares and therefore holding of preference shares also should be taken into account. It is not clear as to how holdings in multiple accounts by a shareholder should be considered for determining whether he is a small shareholder or not. This has been made clear by an explanation appended to section 152(6). In keeping with the objective of this provision it would be appropriate if the holdings under multiple accounts were aggregated. Holdings of a shareholder under joint accounts need not be aggregated unless the other joint holders are common.

Board of Directors

Casual Directors

Vacancies may arise in the Board of Directors by death, resignation or otherwise amongst the directors liable to retire by rotation. Unfortunately there is no provision in the Act as to how such vacancies could be filled in. In the existing Act section 262 provides for such contingencies. In the absence of any provision similar to section 262, there is no other way but to allow these vacancies to lapse and Board taking recourse to the appointment of additional directors in such situations.

Additional Directors

Section 161 of the new Act provides that the Board of Directors of a company through a suitable provision in its Articles of Association could be conferred with the power to appoint any person other than the one who fails to get appointed as a director in a general meeting as additional director. Such an additional director, would hold office up to the date of the next annual general meeting or the last date on which the annual general meeting should have been held, which ever is earlier. The portions highlighted above are deviations from the provisions in this regard contained in section 260 of the present Act. This disqualification, i.e. if he fails to get elected as a director in a general meting, would visit a person if he fails himself to get appointed as a director at any general meeting in the past.

Alternate Directors

Section 161 of the new Act provides that powers could be conferred on the Board for appointment of a person who is not already an alternate director of any other director of the company by having a suitable provision in the Articles or by a resolution passed by a company in general meeting, as an Alternate director of any other director, to act as such, for the other director during his absence for a period of not less than three months from India. The requirement of single alternate directorship and absence from India are the deviations from the existing provisions of section 313. In view of this deviation it should be noted that a person could hold only one alternate directorship in a company. This section also provides that no person could be appointed as an alternate to an independent director unless, he is qualified to be appointed as an independent director. As is currently the position the alternate director would cease to be in office if the original director returns to India. As has been held by the Bombay High Court in *Naina D. Kamani* v. *Janson Engineering and Trading P. Ltd,* [2011] 167 Comp. Cas 89 (Bom): the alternate director would vacate his office of director only if and when the original director returns to India for a length of time and not on a short visit on social or other engagements.

Nominee Directors

Under section 161 (3) of the new Act, even nominee directors have to be appointed by the Board of its Directors. Under the present Act there is no such requirement. On nomination the nominee director from the date of nomination can take his seat on the Board. It is not known why this requirement has been inserted. In view of this new requirement, if the institution nominating the nominee director withdraws the nomination the director concerned has to resign from the Board. At times this may create complications if the nominee director for any reason refuses to resign. This requirement could have been avoided. It needs no reiteration that, such an appointment could be made, only against the one-third the total number of directors of a company and if there is a provision in the Articles of Association of the company concerned in this regard.

BIFR

Under section 17(4) of the Sick Industrial Companies (Special Provisions) Act, 1985, the Board of Industrial and Financial Reconstruction could appoint one or two special directors on the Board of Directors of a sick industrial company under the circumstances set out in the said sub-section. This overrides the provisions in the Companies Act 1956 and any other law for the time being in force or provisions in the Memorandum and Articles of Association of the sick company concerned. Such special directors could be appointed even if the sick industrial company concerned has already fifteen directors, i.e. the ceiling prescribed under the Act, and are not liable to retire by rotation or counted in the total number of directors liable to retire by rotation, etc. This power would automatically stand withdrawn from the date the Sick industrial Companies (Special Provisions) Repeal Act, 2003 is put into force.

National Company Law Tribunal

Under Section 242(2)(k) of the new Act the Tribunal may appoint such number of persons as directors, who may be required to report to the Tribunal on such matters as the Tribunal may direct. This is a new provision. There are no overriding provisions governing this appointment. The Tribunal being clothed with the powers of the Court will, it is hoped that while appointing such directors it would take care of this deficiency and provide for such matters in its order. It should be noted that the Tribunal could not supersede the Board of Directors of a company and constitute a new set of directors. In this respect the new Act seeks to strengthen the democratic right of the shareholders. Further under section 408 of the existing Act, the Central Government has been clothed with powers to appoint with the approval of the Company Law Board directors on the Boards of companies under the circumstances and for the purposes detailed in that section. Such a director need not hold qualification shares, if any, prescribed under the Articles of Association of the company concerned, will not retire by rotation and will not be counted for the purposes of determining the directors liable to retire by rotation. Such a director will also not be taken into account for the purpose of computing two thirds or any other proportion of the total number of directors of the company concerned. No similar power has been conferred on the Central Government under the Act and as a consequence the Central Government cannot appoint directors on companies in the interest of the shareholders or public interest in cases of mismanagement/oppression.

Lenders and State Financial Corporations, etc.

Lenders who are generally financial institutions and Nationalised Banks are conferred with the right to nominate directors on the Boards of companies to which they have extended financial assistance either by the Act constituting them or under which they are constituted or by an agreement entered into by the institution concerned with the borrowing company/ies. The State Financial Corporations which are associated with private sector companies are also conferred with the right to nominate directors on the Boards of such private sector companies. Some of these institutions are constituted by separate enactments and some are incorporated under the Company Legislation in force at the time of their incorporation. In regard to former there are provisions in the Acts constituting them, which are overriding in nature to appoint directors on the Boards of assisted companies notwithstanding the fact that on nomination the ceiling under the Act would be pierced. Such directors are also not liable to retire by rotation and also not to be taken into account for determining the total number of directors liable to retire by rotation and they need not own qualification shares, if any, prescribed under the Articles of companies concerned. In the case of the latter they are amenable to the provisions of the Act and they can be nominated only if there is specific provision in this regard in the Articles of Association of the company concerned. Even in their cases, the persons nominated by the lenders have to be, as noticed earlier, appointed by the Boards of such companies.

Qualifications for appointment as a director

The new Act has not prescribed any qualification for a person to be appointed as a director of a company directly. Impliedly a person cannot be appointed as a director unless he has a Director Identification Number (DIN) as provided under section 152(3) of the new Act. Sections 153 to 159 of the new Act lay down the procedure for obtaining DIN by a person, informing the company in which he is a director, filing it with the Registrar and quoting the said number in all documents and returns filed by him as a director of the company concerned.

Apart from the above in Section 164 of the new Act the qualifications of a director have been defined negatively. In terms of the said clause a director should:

- Be of sound mind.
- Be solvent.
- not have applied for adjudication as an insolvent.
- not have been convicted by a court of any offence, whether involving moral turpitude or otherwise, and sentenced in respect thereof to imprisonment for not less than six months and a period of five years have, at the time of appointment, elapsed.
- not have been disqualified for appointment as a director by any Court or Tribunal and the order is subsisting.
- Have paid calls on shares held by him either singly or jointly within six months of the due date of the respective calls.
- Not have been convicted of an offence dealing with related party transactions under section 188 of the Act during the period of five years before the date of his

appointment.

- Not have been a director of a public limited company which has not filed their financial statements and/or annual returns for a continuous period of three years before five years from the date of their appointment.
- Not have been a director of a public limited company, which has defaulted in the repayment of deposits and interest thereon and/or defaulted in the repayment of debentures and interest thereon on the due date and such a default has continued for a year, before four years from the date of appointment.

This Section further provides that a person convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more cannot be appointed a director of any other company. If a person is not qualified to be appointed as director of a company because of his conviction for an offence involving moral turpitude or otherwise and is sentenced to imprisonment for a period of not less than six months, or of his conviction under section 188 or of an order of a Court or Tribunal, the disqualification would get suspended for a period of 30 days and if an appeal is filed against the order within the said period of 30 days, the disqualification would get suspended for a further period of 7 days after the date on which the order in appeal is pronounced. If further appeal is preferred within the said period of 7 days it will get suspended for a period of 7 days after the date on which the second appeal is decided. A private company can add more qualifications.

Even though the appointment of a director is not a contract but as the person concerned is an agent of the company of which he is a director, unless he has attained majority he cannot be appointed as a director. Thus even though no age qualification has been prescribed unless he is competent to enter into a contract, he cannot be appointed as a director of company. Attaining majority is one of the competencies.

Independent Directors

Under Section 149(4) of the new Act, every listed company is required to have at least one-third of the total number of directors as independent directors. By way of explanation it has been mentioned in this section that any fraction in such one-third should be rounded of as one. It might be appropriate to recall that under Clause 49 of the Listing Agreement every listed company is required to have 50% of its total number of directors, as independent directors, if the Chairman of the company is an executive chairman and 1/3 of its total number of directors as independent directors, if its Chairman is a non-executive Chairman. Section 149(6) of the new Act defines the term 'independent director'. It largely follows the definition of 'independent director' in the listing agreement. It should, however, be noted that a nominee director cannot be an independent director for the purposes of the Act while under the Listing Agreement he is treated so. While there is no limit on the tenure of an independent director in the Listing Agreement, Section 149(11) of the new Act limits his tenure to10 years at a time. He can be considered for appointment after a cooling off period of three years during which period he should not be associated with the company in any capacity. An independent director, under Section 149(10) of the new Act, is required to be appointed by the general meeting to hold office as such for a period of five years. He can be re-appointed for another term of five years by a special resolution and the fact of re-appointment has to be stated in the Director's Report. As noticed earlier the independent director is not liable to retire by rotation and as such, he will have to be accommodated in the one-third of the total number of directors of the company. Under Section 149(7) of the new Act every independent director is required to give a declaration at the first meeting of the Board he attends after his appointment and at the first meeting of the Board in every financial year or whenever there is a change in the circumstances which may affect his status as an independent director, that he meets the criteria of independence as provided in Section 149(6) of the new Act.

Retirement of Directors

Under Section 152(6) of the new Act, one-third the total number of directors for the time being are liable to retire by rotation, have to retire at each annual general meeting. Similar provision exists in the Articles of Association of companies. If the number retiring by rotation is not one third then the number nearest to one third would retire. It should be noted that fractions in the said one-third should not be grossed up as one as in the case of the requirement of the appointment of the independent directors. If a company desires to retire more than this number, then the number in excess of the one-third will have to be retired by a special resolution. This, however, should not be construed to mean that if the Articles of Association of a company provides that all directors would retire at each annual general meeting then the number in excess of one-third can retire only by means of a special resolution. This is so because, in such a situation the company concerned follows the provisions in the Articles and in the case of the former that has the effect of amending the Articles which can be done only by means of a special resolution. Section 152 of the new Act also provides that the directors retiring would be those who have been longest in office and in the event that there are more than the number required to retire at the annual general meeting on this score, the names of the retiring directors subject to the provisions in the Articles will have to be decided by lots.

Resignation of Directors

There is no regulation in the existing Act with regard to resignation of directors. Judge made law largely governs this. The new law aptly regulates the resignation of directors. Section 168 of the new Act exhaustively deals with the matter. This has become a boon to non-executive directors of companies. Under this section a non-executive director can resign by addressing a letter to the

company concerned which the Board of Directors is required to note and inform the Registrar of Companies. The director concerned is also required to forward a copy of his resignation letter within 30 days of the resignation along with detailed reasons for his resignation. The resignation will take effect from the date on which the letter of resignation is received by the company or the date mentioned in the said letter whichever is later. This section further empowers the promoters and in their absence the Central Government to appoint the required number of directors who will hold office till the general meeting appoints the directors. The use of the word 'required number' is significant. The required number would mean that number which is required to hold a board meeting in terms of the provisions in the Act and in the Articles of Association of the company concerned. A Board meeting can be validly convened and held only when there is an effective quorum. In this light the expression 'required number' in Section 168 of the new Act would mean that number of directors who can constitute an effective quorum for a board meeting. In exercise of this power the delegate cannot appoint more directors than that is required to constitute an effect quorum at board meetings. This clause has put at rest various problems faced by non-executive directors, and at times leading to avoidable litigations.

Vacation of Office of Director

Section 167 of the new Act specifies the circumstances in which the office of director will stand automatically vacated. This is generally in line with section 283 of the existing Act, with the exception that if a director is convicted of an offence involving moral turpitude or otherwise and is sentenced in respect of that offence to imprisonment for a period of six months or more, the office of director shall stand vacated even if he files an appeal against his conviction.

Removal

In line with the provisions of section 284 of the existing Act, Section 169 of the new Act specifies the procedure for the removal of directors. It should be noted that as the removal is by means of a resolution, a single shareholder cannot give notice for removal of a director and a proposal for removal of a director can be moved only by a shareholder or shareholders holding the requisite number of shares with voting rights who can give notice of resolutions for consideration at a general meeting as provided in Section 111 of the new Act .

Duties of Directors

All along duties of directors of companies have to be deduced from court judgments. Section 166 of the new Act succinctly lays down the duties of directors, as under:

- He has to act according to the Articles of the company.
- He should act in good faith in order to promote the objects of the company for the benefit of the members as a whole and in the best interest of the company, its employees, its shareholders, the community and for the protection of environment.
- He should exercise his duties with due and reasonable care, skill and diligence and should exercise independent judgment.
- He should not involve himself in a situation in which he may have direct or indirect interest that conflicts, or possibly might conflict with the interest of the company.
- He should not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates.
- He should not assign his office.

If a director is found to have obtained undue gain he is required to pay an amount equal to the gain to the company and if he assigns his office, the assignment would be void. If a director contravenes the above requirements he is liable to be punished with fine, which will be not less than one lakh of rupees and which may extend to five lakh rupees.

Powers of directors

Being agents of the company in regard to dealing with outsiders, individual directors cannot exercise any powers in relation to management of company. Directors can exercise the powers in relation to management of a company collectively as a Board and an individual director could be delegated powers by the Board.

Liability of Directors

Directors will have no personal liability so long as they exercise the duties set out earlier in this Article. It should be noted that pursuant to the provisions of Section 149(12) of the new Act a non executive director including an independent director and nominee directors will be held liable 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.

Under Section 195 of the new Act, a director, *inter alia,* is prohibited from indulging in Insider Trading. There are many provisions in the Act, which are not in line with the Regulations framed in this regard by the Securities and Exchange Board of India, which are applicable to listed companies. Thus in their cases there could be duplications and the requirements of the Act or SEBI Regulations may be stringent. In such situations it would be prudent and in fact is required that listed companies should comply with more stringent requirements of the two so that they are not hauled up for possible violations. CS

The Concept of Corporate Social Responsibility under the Companies Act, 2013 - Whether well conceived?

Although much has been spoken, written and discussed on the corporate social responsibility, nothing concrete had emerged on this so far except some voluntary actions by some corporates. The Companies Act, 2013 for the first time has introduced a welcome provision requiring corporates to mandatorily spend a prescribed percentage of their profits on certain specified areas of social upliftment in discharge of their social responsibilities. To know more on this read this article.

The country has a new law for Companies after long deliberations extending to nearly two decades - the exercise for giving a new Companies Act to replace the Companies Act, 1956 having been started in the year 1993! Obviously in the new law, on whose drafting so much time has been spent, efforts have been made not only to remove the deficiencies noticed in the working of the earlier Act, but also to introduce some new concepts one of which is to make Companies realize their obligations towards the Society of which they are an important constituent and discharge these by spending prescribed part of their earnings for the good of the people. This has been done by introducing in the Act, the concept relating to Corporate Social Responsibility ('CSR' for short). The new law vide section 135 of the Companies Act, 2013 provides that all Companies will have to spend 2% of their average net profit during three preceding years on CSR. The explanation to the clause provides that 'average net profit' shall be calculated in accordance with the provisions of section 198 which mentions the method relating to calculation of profits.

Legal provision in a nutshell

Section 135 of the Companies Act, 2013 provides that it will apply to every company with a net worth of Rs. 500 crores or more, turnover of Rs. 1000 crores or a net profit of Rs. 5 crores or more during any financial year; The amount has to be a minimum of 2% of 'average net profit'.

The amount has to be spent on the 9 broad areas that result in social good as specified in Schedule VII of the new Act. The areas are:

(i) eradicating extreme hunger and poverty;
(ii) promotion of education;
(iii) promoting gender equality and empowering women;
(iv) reducing child mortality and improving maternal health;
(v) combating human immuno deficiency virus, acquired immuno deficiency syndrome, malaria and other diseases;
(vi) ensuring environmental sustainability;
(vii) employment enhancing vocational skills;

(viii) social business projects;
(ix) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled castes, the Scheduled Tribes, other backward classes, minorities and women.
(x) such other matters as may be prescribed.

In spending the funds, the company is to give preference to the local area and areas around it where it operates and the activities to be undertaken will be those specified in Schdule VI.

The residuary sub-clause(x) in the Schedule gives power to the Government to enlarge this list. A number of claims are bound to be made for inclusion in the list by the Government by exercising power under this sub-clause, which is going to be a continuing exercise. The Company falling in any of the categories referred to earlier shall have to constitute a Corporate Social Responsibility Committee (CSRC), which shall formulate and recommend to the Board, a Corporate Social Responsibility Policy, which shall indicate the activities to be undertaken by the company as specified in Schedule VII; recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and monitor the Corporate Social Responsibility Policy of the company from time to time.

The Board of Directors of the Company shall after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the Company's website, if any, in such manner as may be prescribed; and ensure that the activities as are included in Corporate Social Responsibility Policy of the Company are undertaken by the Company. The Board of every company falling in the categories specified earlier has to ensure spending of the amount as prescribed and if the Company fails to do so, the Board shall, in its report made under section 134(3)(o) of the new Act specify the reasons for not spending the amount. Section 134(3)(o) mandates that with financial statements to be presented, there shall be a statement showing the details about the policy developed and implemented by the Company on corporate social responsibility initiatives taken during the year. Section 134(8) of the new Act provides that if it is not done, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall be less than 50 thousand rupees but which may extend to five lakh rupees, or with both.

What is CSR?

There is no definition in the new Act for the term Corporate Social Responsibility though the areas in which the money could be spent have been specified in Schedule VII. Broadly, CSR relates to the companies manning their business in such a way as produces overall positive impact on the society. In other words, it implies a concept, whereby companies decide voluntarily to contribute to a better society and a cleaner environment – a concept, whereby the companies integrate social and other useful concerns in their business operations for the betterment of its stakeholders and society in general in a voluntary way. The Indian scheme is going ahead in this matter by providing spending of 2% of net profits mandatorily for the CSR and in cases of failures in compliance, explanation will have to be given by the directors at the Annual General Meeting.

» There is no definition in the new Act for the term Corporate Social Responsibility though the areas in which the money could be spent have been specified in Schedule-VII. Broadly, CSR relates to the companies manning their business in such a way as produces over all positive impact on the society.

In the United States, the term 'CSR' has been described with a shade of philanthropy. There, besides paying taxes, companies donate a certain share of profits to charitable causes – an act of giving as a reciprocity for receiving something. There cannot be any rigidity in the outlook in this regard. In different countries, there could be different parameters, values and priorities and the companies generally consider this aspect in the background of their core business activities operating their businesses in a way that meet (or exceed) the ethical, legal, commercial and public expectations that the society has from the business. However, no country, appears to have prescribed statutorily any limit for expenditure which has to be mandatorily spent on CSR. India is, perhaps, the first country to proceed in this manner. Some companies despite their having profits, net worths, turnovers, as prescribed may find themselves ill-equipped to engage in broad societal goals. Further, there could be arguments whether the companies could be compelled to assume such roles which legitimately are to be undertaken by the Governments for which they are collecting taxes!

Analytical Appraisal of the Scheme – Impact of new law relating to CSR

India is one of the few countries that have provided by legislation

a scheme of the nature like CSR. Other countries are Sweden, Norway, Netherlands, Denmark & France. Mauritius too has a legislation that mandates spending of 2% of PAT (Profit After Tax) towards CSR. However, the law as enacted is not likely to have wide coverage. Media reports show that according to a study made by Ernst & Young, a Consulting firm, there are more than 13.29 lakh Companies registered with the Registrars of Companies in various parts of the country and out of these only 9 lakh companies are active and out of this, only 8000 companies (even less than 1% of active companies) are likely to be covered by the section 135 on the basis of criteria prescribed. Thus the impact of this provision on the total company population in the country is expected to be minimal.

Conflict between sections 135, 181 and 182

Section 135 relates to CSR. Section 181 allows a company to contribute to bona fide charitable and other funds to any extent with the condition that prior permission of the company in general meeting shall be required for such contribution in case any amount the aggregate of which, in any financial year, exceeds five per cent of its average net profits for three immediately preceding financial years. Section 182 contains prohibitions and restrictions regarding political contributions and starts with a *non-obstante* clause providing that a company, other than a Government company and a company which has been in existence for less than three financial years, may contribute any amount directly or indirectly to any political party. The provisions of sub-sections (2) to (4) do not directly relate to the aspect being considered. These, *inter alia,* provide how other expenditure on the publication like a pamphlet, tract, brochure etc. for and on behalf of a political party too is to be considered as political contribution. The contribution covered by this provision shall have to be disclosed in the profit and loss account for the financial year for which the contribution relates along with the name(s) of recipient party/parties and s.ub-section(4) provides punishment of fine and prosecution in case of non-compliance of the provisions of section 182.

Section 183 gives power to Board of a Company and other persons exercising the power of Board to make contributions to National Defence Fund or any other Fund approved by the Central Government for the Defence of the Country to any extent notwithstanding anything contained in sections 180, 181 and 182. Thus a company has power to contribute to various multi funds for which provisions are contained in the Act. In some situations even 100% income can be contributed to the Funds.

The issue that needs consideration is whether the above mentioned provisions are to operate independently? For example, if contributions are made under section 181 for areas covered by section 135, will such contributions be treated to be compliance of section 135 also; whether political contributions can be said to come under the head 'social business projects' mentioned in schedule VII and hence such payment will be considered as

compliance to CSR obligations and whether CSR expenditure should qualify for deduction under the Income Tax Act?

The Income-tax Act, 1961 (Act) provides tax benefits for expenditure on charitable activities vide sections 11 to 13 and section 10(23C). Should such expenditure by Companies on CSR be made eligible to tax benefits also needs consideration? If so provided, this will encourage expenditure on CSR activities. Such expenditure should normally be admissible under section 37(1) of the Act being expenditure wholly and exclusively incurred for business. A clarification from the CBDT will avoid undue litigation in the matter. Incidentally, contributions to Prime Ministers Relief Fund will get double benefit. These will be entitled to 100% deduction in income tax as well as will be counted against discharge of obligation for CSR under section 135 of the new Act. There are few other institutions which deserve such double benefit if the expenditure on CSR aspects is not considered admissible for deduction under section 37(1) of the ITAct.

Spending on CSR

The only requirement of the first proviso to section 135(5) is that the Company shall give preference to the local area and areas around it where it operates for spending the CSR amount. Of course this is recommendatory and not mandatory but broader perspective in the interest of the country as a whole would get compromised by such requirement.

Relevancy with business

Whether CSR expenditure should have relevance with the business of the Company is an important question. The familiarity with the business will serve twin objectives of bringing more business to the company along with promoting broader social development. The CSR must grow with the growth of the company. This view is countered with the view that the companies need to look beyond their business interests on the ground that

if they aspire to be national and global their reach in the social sector also must be national and global.

Parity with political contributions
Section 183 provides for political contributions up to 7.5% of net profit (increased from existing limit of 5%). In view of this, limiting expenditure for CSR to 2% only seems unfair.

CSR expenses relating to employment
The expression 'employment enhancing vocational skills' in Schedule (VI) needs to be expanded to cover expenditure on employees welfare and efficiency increasing activities also.

Clarity about unspent amount
For how long the unspent accumulated funds for which explanations have been given in the published accounts of the Companies can remain unspent has not been provided. Some time limit for this needs to be prescribed and if the same is not adhered to, the Company and its Directors should be made liable to penal action as provided in section 134(8) of the new Act. Companies should not get away from CSR expenditure merely by giving an explanation for non-spending. The specified unspent amounts should be carried forward and spent in later years within the period to be prescribed unless the reasons given are such that making expenditure is impossible or put the Company to grave consequences.

New head in Schedule VII
A new head needs to be added to Schedule VII of the new Act to provide encouragement to community programmes with a view to improve the quality of community life and to promote the company's long term business strategies and goals.

The phrase 'social business projects' is ambiguous and needs to be elaborated.

CSR needs to be extended to cover philanthropy and charity also.

CSR activities need to be pooled for undertaking major projects in a group. This, if done, would bring in more funds and expertise and may result in better results.

Promotion of education
Promotion of education is one head on which CSR expenditure can be spent. However, for this purpose, 'education' needs to be considered in a broader way and not narrowly as done by the apex Court in the case of *Sole Trustee Loka Shikshana Trust* v. *CIT* (1975) 101 ITR 234(SC) where education has been described as the process of training and developing the knowledge, skill mind and character of students by normal schooling. On the basis of this decision, the IT authorities are disallowing income tax exemption to Institutions like Institute of Chartered Accountants of India, Ahmedabad Management Institute etc. holding that such institutions are not involved in 'normal education' activities. It also needs to be clarified whether under CSR capital expenditure can also be incurred (for example expenditure incurred in constructing a school building) within the prescribed limit of 2%?

Promoters/Directors family or other trusts
It needs to be clarified whether contributions to promoters/ Directors family trusts or trusts in which they are interested will be considered as compliance to CSR obligation if such trusts are promoting the areas mentioned in Schedule VII.

Views and Criticism of the scheme

The CSR concept in the Act has not been universally welcomed. There has been criticism of the proposals by those who believe that welfare of the people is the responsibility of the Government for which it collects taxes and hence this extra burden on the companies is unjustified. Then there is also a view that why only companies should be made to discharge social responsibility! Why not other sectors like Firms, Individuals, Association of Persons etc. who are being assessed to tax. Business Lines dated 12 August 2013 has expressed the following views regarding CSR in its editorial page: "But there are spoilers as well, especially the requirement for companies to compulsorily set aside 2 per cent of their earnings for corporate social responsibility (CSR) activities. Companies are ultimately accountable to shareholders, while philanthropy is something for promoters to pursue in their individual capacities. A mining firm may choose to open schools or hospitals for tribals in its area of operations. Corporates value the goodwill these create, which may even be in their shareholders' long-term interest. The problem from CSR being imposed – by a government increasingly abdicating its own public welfare delivery functions rather than leaving it to the judgement of companies. Enlightened managements know it isn't worth doing business in places where the locals don't want them. One hopes the 'rules' under the new

> To give incentive to companies to excel in the area of CSR, companies should be given 'CSR credits' on the lines of Carbon credits on the basis of criteria fixed in advance for giving such credits on priority basis namely giving more credits to the areas that are more important from national perspective and less to others in priority order.

law provide enough leeway to make CSR a true value proposition for firms".

In an interview published in "The Economic Times" of 14th August, 2013 the Minister of State for Corporate Affairs has expressed the following views regarding CSR :"It is a new idea, a new beginning. India is perhaps the first country in the world to have CSR in a statute and it has been well received by corporate India. There have been problems in manufacturing and in mining sectors with regard to the trust deficient between the people who live in tribal areas and the large companies which operate there. Paying taxes to the federal structure is part of the law of the land, but CSR initiative can be used to win the endearment of people. You are also adding to your potential talent pool by contributing to quality education and healthcare. Religious donation can't be considered as CSR." Regarding funding religious trusts through CSR, the Minister stated that he was against any religion's donation to be counted as part of CSR but the final decision rests with the rule committee and I will not like to interfere with their work." On some other aspects, the Minister observed :"I feel CSR is an avenue for companies to earn that 'goodwill' which sponsorships can't. Corporate houses spend so much money on media to get eyeballs. The kind of impact CSR can create in the hearts and minds of people is phenomenal. To improve the investment climate, to create better investment opportunities we need that harmonization. So CSR has many facets to it, besides this 2% contribution. It's not just the quantum of money, but quality of work. I don't want to straightjacket a company but it shouldn't be done with an idea to get commercial benefits out of it."

Concluding comments

Being a new concept in the context of companies legislation, there could be varied views regarding CSR. It is a part of Companies responsibility towards the society and these being the organized sector in the business arena, there should be no grudge in undertaking it. Actually, companies are contributing to various areas concerning society in a disjointed way. What they presently do in an unorganized way and in some cases for benefit of some particular sections in some cases will now ensure for public good. Further, there will be advantage to the companies contributing towards CSR activities because it will enhance their images as socially responsible entities which understand the need of the day towards the society be it towards a green revolution or towards disabled persons or persons with terminal illnesses who cannot afford the cost of treatment. It would ensure better compliance, if each company keeping in view its area of activity declares its CSR policy each year as Annexure to Directors reports in clear terms relating to eradicating hunger and poverty, promotion of education, women empowerment, reduction in child mortality and improving national health, environmental sustainability, enhancement, employment and vocational skills or contributions to Central or State Government set up funds including the Prime Ministers National Relief Fund or in regard to any other area prescribed by the Government from time to time.

To give incentive to companies to excel in the area of CSR, companies should be given 'CSR credits' on the lines of Carbon credits on the basis of criteria fixed in advance for giving such credits on priority basis namely giving more credits to the areas that are more important from national perspective and less to others in priority order. These credits should not be transferable or saleable like carbon credits. These should count for National Awards to be announced by the Ministry of Corporate Affairs annually in functions to be organized at different places on yearly basis. Ten companies should be given award each year on the basis of such credits. The awards should be in terms of trophies.

Considering the fact that on the basis of prescribed criteria, the coverage of CSR is narrow (only 8000 companies are expected to be covered), it needs to be enlarged by suitably reducing the monetary limits. This will give wider participation, which will be good in the longer run.

There should be specific audit of expenditure on CSR during annual statutory audits of the Companies regarding compliance to CSR obligations. The ICAI should amend the auditing report format on companies to include a special mention about the CSR in the Auditor's report. This would avoid superficial approaches to compliance of CSR provisions in the Act namely, Section 135.

To make the scheme meaningful, a Committee of in-house officers of the Ministry of Corporate Affairs may be formed to examine the various aspects relating to functioning of the scheme immediately which can examine the relevant issues and frame appropriate guidelines for the implementation of the CSR scheme, which is apparently well thought of and should be welcome. This Committee's work should not be confined to only making rules concerning the new areas to be covered in terms of clause (x) of Schedule VII of the new Act. CS

Inspection, Investigation, Serious Fraud Investigation Office

In the context of recent corporate frauds like that of Satyam, the company law provisions dealing with inspection and investigation of the affairs of companies have been strengthened under the new law. The Serious Fraud Investigation Office has also been vested with wider powers to prevent recurrence of Satyam like incidents.

Chapter XIV of the Companies Act, 2013 deals with inspection, through Sections 206 to 209 and with investigation, through Sections 210 to 229.

Section 206 specifies the power of the Registrar to call for information and inspect books and conduct inquiries.

A reading of the provisions of Section 206 of the new Act shows that there has been a mix of disconnected concepts and that it does not deal with inspection of the records of a company, pure and simple, like section 209A of the 1956 Act. More than that some of the terms are vague and could expose the company to vexatious litigation. Section 209A provided only for inspection of the books of account and other books and papers of a company.

Section 206(1) provides for inspection by the Registrar following from his scrutiny of any document filed by a company or information received by him. The section does not indicate the *locus standi* of the person, *vis-a-vis* the company, giving any information to the Registrar that would trigger the process of inspection.

The officers concerned are required to furnish information or explanation to the `best of their knowledge and power'. Information obtained under this qualification would have little value. Also, one cannot envisage a situation when those occupying positions in the company are not in a position to give the necessary information or explanation to the Registrar on the records with the company and there would be a need to require a past employee to give that information or explanation. What would be the value of the explanation given by a past employee to `the best of his knowledge' on a past transaction, assuming that he is available and willing to cooperate?

The provision entitling the Registrar to issue a further notice on the ground that an unsatisfactory state of affairs exists in the company and does not disclose a full and fair statement of the information required could be challenged on the ground that the section does not define `an unsatisfactory state of affairs in the company', besides the basis being subjective and much too wide.

Similarly, the provision authorizing the Registrar to carry out an inquiry if he is satisfied on the basis of information available with or furnished to him or on a representation made to him by any person that the business of a company is being carried on for a fraudulent or unlawful purpose or not in compliance with the provisions of this Act or if the grievances of investors are not being addressed, is also open to attack on the ground that the discretion vested in the Registrar is unfettered, as the grounds on which he may act are not specific at all.

What is the *locus standi* of the person who may make a representation

> Where the Central Government has ordered an investigation by the SFIO, no other investigating agency of Central Government or any State Government shall proceed with investigation in respect of any offence under this Act and if any such investigation has already been initiated, it shall not be proceeded further with and the concerned agency shall transfer the relevant documents and records in respect of such offences under this Act to the SFIO.

to the Registrar as stated above and what are the records which the informant is bound to file with the Registrar and what responsibility he is asked to undertake to substantiate his allegations, for example security for costs, when he is on the point of initiating an inquiry by the Registrar. Unless, he is a shareholder or a debenture holder or creditor what would be his stake in making such a sweeping complaint against the company and on what records enjoining the Registrar to start a speculative inquiry? The fact that the company would be given a reasonable opportunity of being heard is no comfort as the provision confers a right on one who has no interest in the company. Sub-section (4) is a gateway to frivolous and vexatious harassment of a company by outsiders without their being held accountable for their acts.

What are the circumstances in which the Central Government could itself appoint an inspector, when there is a Registrar is not clear.
The second proviso is perplexing. Who is the authority to determine that the business of the company has been or is being carried on for a fraudulent or unlawful purpose? It is a lacunae in a section dealing only with inspection. That the business of the company is carried on in this manner is a crucial decision that will have to be determined by a court. Sub-section (6) is general provision empowering the Central Government to authorize, having regard to the circumstances, by general or special order, any statutory authority to carry out the inspection of books of account of a company or class of companies. Sub-section (7) providing for the punishment for failure to furnish any information or explanation or produce any document is more severe than that provided under section 209A.

Section 207(1) casts a duty on the officers and employees of the company which is the subject of an inspection to submit the necessary documents, information and assistance to the Registrar or an inspector, if one has been appointed; sub-section (2) deals with making of copies, of the documents and marking any of them, during inspection, for record purposes; sub-section (3) is similar to section 209A(5) vesting in the Registrar or the inspector appointed, the powers of a civil court under the Code of Civil Procedure, 1908; sub-section (4) provides for the penalty for disobeying any direction of the Registrar or the inspector and the vacation of office of a director convicted of an offence under this section, from the date of his conviction.

Section 208: Registrar or the inspector shall submit a report to the Central Government, after his inspection and inquiry, along with any relevant document. He may, if necessary, include a recommendation that further investigation into the affairs of the company is necessary, giving his reasons in support.

It is not clear when such a further investigation is likely to be ordered on the company and on what matters and whether the company would at that stage be informed of the grounds for making that recommendation.

Section 209 provides for search and seizure, by the Registrar or the inspector, of books and papers of a company, or those relating to the key managerial personnel or any director or auditor or company secretary in practice if the company has not appointed a company secretary. He may initiate action, after obtaining an order from the Special Court, upon information in his possession or otherwise, when he has reasonable ground to believe that any of the above books or papers are likely to be destroyed, mutilated, altered, falsified or secreted. The provisions of the Code of Criminal Procedure, 1973 relating to searches or seizures shall apply, *mutatis mutandis,* to every search and seizure made under this section.

It is not clear as to how prior information will reach the Registrar or the inspector when the company attempts to engage in such acts.

Investigation

Sections 210 to 229 deal with investigation into the affairs of a company. We may consider the substance of some of the major provisions, leaving out those dealing only with procedure.

Section 210 empowers the Central Government to order an investigation into the affairs of a company in the following cases: (i) on the receipt of a report of the Registrar or inspector under section 208; (ii) on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or (iii) in public interest. But the Central Government is bound to order an investigation into the affairs of a company if an order has been passed by a court or the Tribunal in any proceedings before it that the affairs of a company ought to be investigated. The Central Government, while ordering an investigation may appoint one or more persons as inspectors to investigate into the affairs of the company and to report thereon in such manner as it may direct.

Serious Fraud Investigation Office (SFIO)

The Serious Fraud Investigation Office was set up by the Government of India under the Ministry of Corporate Affairs by a resolution dated 2.7.2003. The office was set up to investigate corporate frauds of serious and complex nature. SFIO is a multi-disciplinary investigating

agency, where experts from the banking sector, capital market, company law, law, forensic audit, taxation, information technology etc. worked together to unravel a corporate fraud. SFIO conducted its investigation under Sections 235 to 247 of the 1956 Act. It became the main investigating agency to investigate affairs of companies where *prima facie* wrong doings are noticed under Sections 235, 236 and 237 of the Act. SFIO was also asked by the Courts to also undertake investigations in pursuance of PILs etc.[1]

SFIO Report 2009

On April 29, 2009, the Expert Committee headed by Shri Vepa Kamesam submitted its Report on issues concerning the Serious Fraud Investigation Office.[2] The Committee was constituted by the Ministry of Corporate Affairs to examine various issues relating to SFIO and to suggest statutory, administrative and organizational changes for improving the effectiveness and to ensure efficient discharge of duties of SFIO. Some of its major recommendations were: (i) an exclusive jurisdiction may be carved out for corporate frauds under the Companies Act, 1956, irrespective of whether it has features of an offence under the IPC or not; (ii) provision of an adequate statutory means to control corporate fraud through an appropriate investigative, enforcement and penalty structure; (iii) strengthen the investigative powers of SFIO and to accord statutory recognition to SFIO in the Companies Act itself; (iv) strengthen the powers of the inspectors appointed under the Companies Act, 1956 to make them more effective in dealing with frauds relating to companies; (v) special legislation may be considered, long term, to deal with fraud in a broad sense and to set up an agency to investigate fraud; (vi) increasing the level of punishment for failure to furnish information to the investigating inspector; similarly the penalty for furnishing false information or withholding relevant information under section 628 is also to be enhanced; (vii) the offence under section 68 ([Penalty for fraudulently inducing persons to invest money) should be made non-compoundable with imprisonment and monetary penalty linked with the quantum of investment so procured.

1 Paragraphs 1.14.1 to 1.14.3 of56th Annual Report on the Working & Administration of the Companies Act, 1956 year ended March 31, 2012.

2 The entire Report may be browsed at the website of the Ministry of Corporate Affairs www.mca.gov.in

Establishment of the SFIO

As stated earlier, Section 211 provides for the establishment of Serious Fraud Investigation Office, through a notification by the Central Government, to investigate frauds relating to a company. Till this notification is issued, the Serious Fraud Investigation Office set-up by the Central Government in terms of the Government of India Resolution No. 45011/16/2003-Adm-I, dated the 2nd July, 2003 shall be deemed to be the Serious Fraud Investigation Office for the purpose of this section. It also provides for the staffing of the SFIO, their experience and terms and conditions of service.

Initiation of the process by the Central Government of investigation by the SFIO

Section 212: The Central Government may also order an investigation of the affairs of a company by the Serious Fraud Investigation Office in the following cases: where there is a report of the Registrar or inspector under Section 208; on intimation of a special resolution passed by a company that its affairs are required to be investigated; in the public interest; or on request from any Department of the Central Government or a State Government.

Where the Central Government has ordered an investigation by the SFIO, no other investigating agency of Central Government or any State Government shall proceed with investigation in respect of any offence under this Act and if any such investigation has already been initiated, it shall not be proceeded further with and the concerned agency shall transfer the relevant documents and records in respect of such offences under this Act to the SFIO.

The SFIO shall conduct the investigation in the manner and follow the procedure provided in this Chapter; and submit its report to the Central Government within such period as may be specified in the order. The investigating officer shall have the power of the inspector set out under section 217. The company and its officers and employees, who are or have been in employment of the company shall be responsible to provide all information, explanation, documents and assistance to the Investigating Officer as he may require for conduct of the investigation. The section also provides that certain offences listed therein and which attract the punishment for fraud as provided in section 447, are cognizable and states the conditions when a person accused of any these offences may be released on bail.

On completion of the investigation, the SFIO shall submit the investigation report to the Central Government. On receipt of the investigation report, the Central Government may, after examination of the report (and after taking such legal advice, as it may think fit), direct the SFIO to initiate prosecution against the company and its officers or employees, who are or have been in employment of the

company or any other person directly or indirectly connected with the affairs of the company. Any investigation or other action taken or initiated by Serious Fraud Investigation Office under the provisions of the Companies Act, 1956 shall continue to be proceeded with under that Act as if this Act had not been passed.

Investigation by an order of the Tribunal: Section 213

The Tribunal may order that the affairs of the company ought to be investigated by an inspector or inspectors appointed by the Central Government if on an application made by (a) not less than one hundred members or members holding not less than one-tenth of the total voting power, in the case of a company having a share capital; or (b) not less than one-fifth of the persons on the company's register of members, in the case of a company having no share capital, and offering evidence supporting their case that they have good reasons for seeking an order for conducting an investigation into the affairs of the company. The section also permits an application for an order of investigation from the Tribunal by one who is not a member as defined above. He may make an application to the Tribunal and the Tribunal may make an order, after giving a reasonable opportunity of being heard to the parties concerned, that the affairs of the company ought to be investigated by an inspector appointed by the Central Government. For the Tribunal to conclude that an order for investigation can be made, it should be satisfied that there are circumstances suggesting that [a] the business of the company is being conducted with intent to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose, or in a manner oppressive to any of its members or that the company was formed for any fraudulent or unlawful purpose; [b] persons concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other misconduct towards the company or towards any of its members; or [c] the members of the company have not been given all the information with respect to its affairs which they might reasonably expect, including information relating to the calculation of the commission payable to a managing or other director, or the manager, of the company. On such an order being passed by the Tribunal the Central Government shall appoint one or more competent persons as inspectors to investigate into the affairs of the company in respect of such matters and to report in such manner as the Central Government may direct.

If it is proved after inspection that, the business of the company is being conducted with intent to defraud its creditors, members or any other persons or otherwise for a fraudulent or unlawful purpose, or that the company was formed for any fraudulent or unlawful purpose or any person concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, officer of the company who is in default and the person or persons concerned in the formation of the company or the management of its affairs shall be punishable for fraud in the manner as provided in section 447.

What are the `good reasons' for seeking an order of investigation by the Tribunal has not been indicated at all. It cannot be a subjective conjecture of the applicant which will expose the company to speculative litigation. Where the complaint is that the business of the company is conducted in a manner oppressive to any of its members, the applicant should be directed to pursue the remedies under Chapter XVI dealing with oppression and mismanagement. A company that may be charged as having been formed for any fraudulent or unlawful purpose cannot obtain registration at all. Information relating to calculation of the commission payable to a managing or other director, or the manager, of the company will be shown in the accounts placed before the company in general meeting and any clarificatory information may be obtained at the annual general meeting at which the directors and the statutory auditor would be available. This cannot be a ground for making an application to the Tribunal. The fact that this was a ground under the 1956 Act is no justification when reviewing legislation is made.

Sections 214 to 229 deal with related matters. They are: security for payment of costs and expenses of investigation; ineligibility of a firm, body corporate or association to be appointed as inspector; investigation of ownership of company; procedure, powers, etc., of inspectors; protection of employees during investigation; power of inspector to conduct investigation into affairs of related companies, etc.; seizure of documents by inspector; freezing of assets of company on inquiry and investigation; imposition of restrictions upon securities; inspector's report; actions to be taken in pursuance of inspector's report; expenses of investigation; voluntary winding up of company, etc., not to stop investigation proceedings; legal advisers and bankers not to disclose certain information; investigation, etc., of foreign companies; penalty for furnishing false statement, mutilation, destruction of documents.

Investigation and punishment for corporate crime

What is the way forward?

In India, the record of punishment of those who swindle the money of investors, is poor. In recent times, the case of Satyam Computers has been shown to be a surprising challenge to those enforcing legislation relating to companies. The fraud of the promoter came to be known only on his confession and not on any investigation. The sad part is that the offenders in that case have not been punished till now. As is known to everyone, including those defrauding other people of their investments, legislation is not enough. Special expertise in investigating crimes such as insider trading, investment through the channels of money-laundering and other devious methods which corrupt the integrity of the capital market is necessary, because communications relating to these offences are not put in writing. Unless disposal of cases of these crimes is quick and the punishment is severely dissuasive, the perpetrators will take advantage of the deficiencies in the system of enforcement. CS

The Companies Act, 2013 – Stringent Disclosures in the Board's Report, Company's Annual Return and Certification by the Company Secretary

In this article, an attempt has been made by the author to highlight some of the new stringent and onerous provisions relating to the Company Board's functioning and also the importance of added responsibility of company secretaries more particularly with regard to the disclosure requirements.

INTRODUCTION

The Parliament has recently passed the Companies Bill, 2012 which has been assented as the Companies Act, 2013. The Act, 2013 will replace the 57 years old Companies Act, 1956. Apart from introducing many definition clauses relating to the Duties of the Directors and the additional disclosures of non-financial information envisaged in the Annual Return ('AR') as compared to the existing format, the Act, 2013 also defines the duties of the Company Secretary ('CS') with regard to compliance management. As against 658 sections in the existing Companies Act, 1956, the Act, 2013 has 470 Sections and can be viewed as less voluminous. The Central Government has been empowered to prescribe rules in respect of a large number of provisions of the new Act.

Many new provisions have been incorporated and new definitions have been added, which is a welcome move for good corporate governance and it is hoped that this will simplify the task of the professionals associated with the corporate sector and clarify many doubts and confusions resulting from complications in implementing the provisions of Companies Act, 1956. The new Act provides for appointment of 'Key Managerial Personnel'('KMP') by the companies and defines who they are. Considering the significant role played by the company secretaries, they have been included in the definition of KMP. The new Act mandates the appointment of Independent Directors in the companies and defines their duties. As a welcome move, the Act, 2013 also prescribes appointment of woman directors in certain companies. Class action suits against companies and the concept of 'Corporate Social Responsibility'('CSR') have been included.

Even though the directors on the Boards of companies, and the corporate professionals associated with companies ought to familiarise with the changed provisions what is important to note is that while the corporate sector has been freed from the shackles of excessive rules and regulations, and it seems that the Legislature has assumed that the Indian corporate sector has, at long last, matured and therefore the company directors and the

associated corporate professionals have been entrusted with stringent responsibilities and they will be held accountable for lapses in compliance. The Companies Act, 2013 not only attempts to ensure the compliance with the provisions of the Companies Act by the companies, but it also wants the Board of Directors ('BOD') and the certifying Company Secretary ('CS') to ensure that the provisions of all other applicable laws have been complied with. This is a stringent and onerous responsibility on the directors as well as on the CS and time only tells how this part of the requirement has been scrupulously followed by the companies. This will strengthen dependency on the in-house professionals as also the outside experts.

In this article, an attempt has been made to highlight some of the changed stringent and onerous provisions relating to the Company Board's functioning and also the importance of added responsibility of the CS, more particularly with regard to the disclosure requirements.

Powers of the Board

Section 179 of the Act, 2013 stipulates, *inter-alia*, that, subject to the provisions of the Memorandum or Articles of Association ('AA') of a company and subject to specific provisions of the Act,including the regulations made by the company in general meeting, the BOD of a company shall be entitled to exercise all such powers, and to do all such acts and things, as the company is authorised to exercise and do. The Board will approve the financial statements and the BOD's report [Section 179 (3g)]. Restrictions on the powers of the Board have been enumerated in Section 180. As per Section 184 directors have to give a declaration of their interest in contracts. However, an important change is that exemption from this clause's applicability in the case of a private limited company, which was available earlier, has been done away with and the new provision stipulates that an interested director cannot vote or take part in the discussion relating to such contract or matter in which he is interested.

Loans to Directors

With regard to giving of loans to directors, Section 185, *inter-alia*, stipulates that without passing of a special resolution, no company, be it public or private, can give any loan or provide security or guarantee in connection with a loan to a director or any other person in whom he is interested. Contraventions will entail payment of huge fine on the part of the company concerned, as well as for the director concerned who will be liable to pay hefty fine or liable to imprisonment, extendable upto 6 months or with both.

Investment by companies

At long last, Section 186, *inter-alia*, curbs the misuse of funds invested by a company in another company. Section186 provides that a company, unless otherwise prescribed, shall make investment through not more than 2 layers of investment companies. Limits on loan or giving of guarantee have been

The Companies Act, 2013 not only attempts to ensure the compliance with the provisions of the Companies Act by the companies, but it also wants the Board of Directors ('BOD') and the certifying Company Secretary ('CS') to ensure that the provisions of all other applicable laws have been complied with. This is a stringent and onerous responsibility on the directors as well as on the CS and time only tells how this part of the requirement has been scrupulously followed by the companies. This will strengthen dependency on the in-house professionals as also the outside experts.

provided in section 186(2) and covers loans not only to a body corporate but also to a person. The company shall disclose to members in the Financial Statement the full particulars of the loans given, investments made or guarantee given or security provided and the purpose for which the loan or guarantee or security is proposed to be utilised by the recipient of the loan or guarantee or security [Section 186(4)]. No resolution sanctioning of loan or guarantee or security shall be passed, unless all directors present in the meeting vote in its favour and with the approval of financial institutions in certain cases[Section 186(5)]. No loan shall be given at a rate of interest lower than the prevailing rate of interest. Section 186(7)]. Contraventions will entail imposing fines on the company concerned and every officer responsible for such non-compliance will be not only liable to pay a hefty fine, but with imprisonment extendable upto 2 years [Section 186(13)].

Restrictions on related party transactions

Section 188 prescribes new restrictions on 'related party transactions'. Section 2(76) of the new Act defines 'related party' with reference to a company to mean:

i) A director or his relative;
ii) A KMP or his relative;
iii) A firm, in which director, manager or his relative is a partner;
iv) A private company in which a director or manager is member or director;
v) A public company in which a director or manager is a director or holds along with his relatives, more than 2 (two) percent of its paid up share capital;
vi) Any body corporate whose BOD, Managing Director or Manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;
vii) Any person on whose advice, directions or instructions, a

director or manager is accustomed to act: provided that nothing in clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;

viii) Any company which is – (A) a holding, subsidiary or an associate company of such company; or (B) a subsidiary of a holding company to which it is also a subsidiary;

ix) Such other person as may be prescribed.

Section 2 (51) defines 'key managerial personnel', in relation to a Company as –

(i) Chief Executive Officer (CEO) or the Managing Director ('MD') or the Manager;
(ii) Company Secretary;
(iii) Whole Time Director;
(iv) Chief Financial Officer;
(v) Such other officer as may be prescribed.

Section 188 (1) stipulates that "Except with the consent of the BOD, given by a resolution at a Board meeting and subject to such conditions as may be prescribed, no Company shall enter into any contract or arrangement with a Related Party with respect to –

(a) Sale, purchase or supply of any goods or materials;
(b) Selling or otherwise disposing off, buying, property of any kind;
(c) Leasing of property of any kind;
(d) Availing or rendering of any services;
(e) Appointment of any agent for purchase or sale of goods, materials, services or property;
(f) Such Related Party's appointment to any office or place of profit in the Company, its subsidiary Company or associate Company; and
(g) Underwriting the subscription of any securities or derivates thereof of the Company:

It is provided that subject to regulations to be prescribed and passing of special resolution, contracts can be entered into. No member who is a 'Related Party' will be entitled to vote on the special resolution. The restrictions shall not apply to any transactions entered into by the Company in its ordinary course of business, other than transactions which are not on arm's length basis. The expression "arm's length transaction" means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.

Section 188(2) stipulates that every contract or arrangement entered into under sub-clause (1) shall be referred to in the BOD's Report to the shareholders along with the justification for entering into such contract or arrangement. The company may proceed against a director or against any other employee who has contravened the provisions of this clause for recovery of any loss sustained by it as a result of such contract or arrangements.

Section 188(5) provides that any Director or any other employee of the Company who had entered into or authorized the contract or

arrangement in violation of the provisions of this section shall be punishable with imprisonment for a term extendable upto 1 year or with fine which shall not be less than Rs.25,000/- but which may extend to Rs.5,00,000/- or with both; and in case of any other company, be punishable with fine ranging between Rs.25,000/- to Rs.5,00,000/-.

To prevent misuse of frittering away of company properties to interested persons, Section 192 stipulates that no Company shall enter into arrangements by which

a) a Director of the Company or its holding, subsidiary or associate Company or a person connected with him, acquires or is to acquire assets for consideration other than cash from the Company; or
b) the Company acquires or is to acquire assets for consideration other than cash, from such Director or person so connected unless prior approval for such arrangement is accorded by a resolution of the Company in general meeting and if the Director or connected person is a Director of its holding company, approval under this sub-section shall also be required to be obtained by passing a resolution in general meeting of the holding company.

Prohibition of forward dealings in securities

Section 194 prohibits forward dealings in securities of Company by Director or key managerial personnel. However, a very important provision has been incorporated in Section 195 which prohibits "insider trading" of securities. This Section provides that no person including any Director or KMP of a Company shall enter into insider trading: Provided that nothing contained in this sub-section shall apply to any communication required in the ordinary course of business or profession or employment or under any law. For the purposes of this Section, "insider trading" means –

(a) an act of subscribing, buying, selling, dealing or agreeing to subscribe, buy, sell or deal in any securities by any Director or KMP or any other officer of a Company either as principal

or agent, if such Director or KMP or any other officer of the Company is reasonably expected to have access to any non-public price sensitive information in respect of securities of a Company; or

(b) an act of counselling about procuring or communicating directly or indirectly, any non-public, price-sensitive information to any person.

It has been clarified that "Price Sensitive Information" means, any information which relates directly or indirectly to a Company and which, if published, is likely to materially affect the price of securities of the Company. Contravention of the provisions of this section shall render a person punishable with imprisonment extendable upto 5 years or with fine ranging between Rs.5,00,000/- to Rs.25,00,00,000/- or thrice the amount of profits made out of the insider trading, whichever is higher or with both.

Key managerial personnel

Section 203 stipulates that every company belonging to such class or classes of companies as may be prescribed shall have the following whole-time KMP :-

i) MD, or CEO or Manager and in their absence, a whole-time director;
ii) CS; and
iii) CFO.

This section further stipulates that an individual shall not be appointed or re-appointed as Chairperson of the company in pursuance of the Articles of the company, as well as the MD or CEO of the company at the same time after the date of commencement of the new Act, unless the Articles of such company provides otherwise; or the company does not carry multiple businesses. Every whole-time KMP of a company shall be appointed by means of a resolution of the BOD containing terms and conditions of appointment, including remuneration. Since the CS has been assigned a very important role in corporate governance, it is felt that his appointment by means of a Board Resolution will at least give him the courage to be forthright and not to buckle under pressure of the promoters/directors. The clause further stipulates that a whole-time KMP shall not hold office in more than one company, except in its subsidiary company at the same time. A KMP shall be entitled to be a director of any company, with the permission of the BOD. A company may appoint or employ a person as its MD, if he is the MD or manager of one, and of not more than one other company and such appointment or employment is made or approved by a Board resolution passed with the consent of all directors present at the meeting and of which meeting, and of the resolution to be moved thereat, specific notice has been given to all directors then in India. Further, if the office of any whole-time KMP is vacated, the resulting vacancy shall be filled up by the BOD at a Board meeting within a period of six months from the date of such vacancy. Thus, the tendency to delay filling up of vacancies in the office of KMP has been curbed, which suited the whims and fancies of some selected persons. Contravention of these provisions will entail payment of hefty fines as stipulated and it is hoped that this will not affect smooth functioning of the company and its corporate governance norms.

Functions of company secretaries

Section 203 is a new provision and elaborates the functions of the company secretary (CS). It stipulates that the functions of a CS shall include –

a) to report to the BOD about compliance with provisions of this Act i.e. the Companies Act, and the rules made thereunder and other laws applicable to the company;
b) to ensure that the company complies with applicable secretarial standards;
c) to discharge such other duties as may be prescribed.

Thus, the CS's duty is to ensure compliance not only with provisions of the Companies Act but also with other laws applicable to the company and will change his position from mere "CS" to that of a 'Compliance Officer'/'Corporate Governance Officer' which mandates such an appointee to be very well-versed not only with the newly added provisions , but also with compliance requirements of all other applicable laws. From corporate governance parlance and disclosure reporting purposes, this is definitely a very positive move. However, it is felt that the earlier accepted view that a CS is an expert only in the Companies Act, will no longer hold good as, now the CS will have to be well versed with other applicable laws. Since this forms part of his mandated duties, the CS may take help of different in-house/outside experts to enable him to fulfil his duties and obligations.

Duties of directors

Section 166 is a new provision which defines the duties of Directors. The said section stipulates that :-

i) subject to provisions of the Act, a director of a company shall act in accordance with the AoA of the company;
ii) a director of a company shall act in good faith in order to

In terms of Section 92(2), the AR filed by a listed company, or by a company having such paid up capital and turnover as may be prescribed, shall be certified by a CS in practice in the prescribed form, stating that the AR discloses the facts correctly and adequately and that the company has complied with all provisions of this Act. An extract of the AR in such form as may be prescribed shall form part of the Board's Report.

promote the objects of the company for the benefit of members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.

iii) A director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgement;

iv) A director of a company shall not involve in a situation in which he may have direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company;

v) A director of a company shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay to the company an amount equal to that gain;

vi) A director of a company shall not assign his office and any assignment so made shall be void;

vii) If a company director contravenes the provisions of this section, such director shall be punishable with fine which shall not be less than Rs.1,00,000/-, but which may extend to Rs.5,00,000/-.

viii) Another important provision in the new Act relates to preparation and filing of Annual Return ('AR'), corresponding to Sections 159, 160, 161 and 162 of the Companies Act, 1956.

One of the important duties of company directors is preparation of the AR and the prescribed Financial Statements. In this regard, Section 92 stipulates that every company shall prepare an AR in the prescribed form containing the following particulars as they stood on the close of the financial year regarding –(a) its registered office, principal business activities, particulars of its holding, subsidiary and associate companies; (b) its shares, debentures and other securities and shareholding pattern (c) its indebtedness; (d) its members and debenture-holders along with changes therein since the close of the previous financial years (e) its promoters, directors, key managerial personnel along with changes therein since the close of the previous financial year; (f) meeting of members or a class thereof, Board and its various committees along with attendance details; (g) remuneration of directors and KMP; (h) penalty or punishment imposed on the company, its directors or officers and details of compounding of offences and appeals made against such penalty or punishment;(i) matters relating to certification of compliances, disclosures as may be prescribed;(j) details, as may be prescribed, in respect of shares held by or on behalf of the Foreign Institutional Investors indicating their names, addresses, countries of incorporation, registration and percentage of shareholding held by them; and(k) such other matters as may be prescribed, and the Statement is to be signed, *inter-alia,* by a director and the CS or where there is no CS, by a CS in practice.

In terms of Section 92(2), the AR filed by a listed company, or by a company having such paid up capital and turnover as may be prescribed, shall be certified by a CS in practice in the prescribed form, stating that the AR discloses the facts correctly and adequately and that the company has complied with all provisions of this Act. An extract of the AR in such form as may be prescribed shall form part of the Board's Report. [Section 92(3)].

Every company shall file with the Registrar of Companies a copy of the AR, within 60 days from the date on which the annual general meeting (AGM) is held. Where no AGM is held in any year, within 60 days from the date on which the AGM should have been held together with the statement specifying reasons for not holding AGM, with such fees or additional fees as may be prescribed, within the specified time.[Section 92(4)].

Failure of company to file its AR within specified period shall entail payment of fine between Rs.50,000/- to Rs.5,00,000/- and every defaulting officer of the company shall be punishable with imprisonment for a term extendable upto 6 months or with fine which shall not be less Rs.50,000/- to Rs.5,00,000/- or with both [Section92(5)].

If a CS in practice certifies the AR otherwise than in conformity with the requirements of this section or the rules made thereunder, he shall be punishable with fine ranging between Rs.50,000/ to Rs.5,00,000/-[Section 92(6)].

Section 134 stipulates that it shall be the duty of the BOD of a company to prepare, for disclosure to shareholders, a Financial Statement, including consolidated financial statement, if any, and such a statement shall be approved by the BOD before they are signed on behalf of the Board by, at least by the Chairperson of the company where he is authorized by the Board or by two directors, out of which one shall be the MD and the CEO, if he is a director in the company; the CFO and the CS of the company for submission to the Auditor for his report thereon. The Auditors' Report shall be attached to every financial statement. The new provision further stipulates that there shall be attached to

statements laid before a company in general meeting, a report by its BOD, which shall include –

i) The extract of the AR as provided under sub-section(3) of Section 92;
ii) Number of meetings of the Board;
iii) Directors Responsibility Statement;
iv) A statement on declaration given by Independent Directors under sub-section (6) of section 149;
v) In case of a company covered under section 178(1), company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under sub-section (3) of section 178;
vi) Explanation or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the Auditor in his report; and by the CS in practice in his Secretarial Audit Report;
vii) Particulars of loans, guarantees or investments under section 186;
viii) Particulars of contracts or arrangements with related parties referred to in Section 188(1) in the prescribed form;
ix) The state of the company's affairs –
    a) The amounts, if any, which it proposes to carry to any reserves;
    b) The amount, if any, which it recommends should be paid by way of dividend;
    c) Material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report;
    d) The conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner, as may be prescribed;
    e) A statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which, in the opinion of the BOD may threaten the existence of the company;
    f) The details about the policy developed and implemented by the company on CSR initiatives taken during the year;
    g) In case of a listed company and every other public company having such paid up share capital as may be prescribed, a statement indicating the manner in which formal annual evaluation has been made by the BOD of its own performance and that of its Committees and individual directors;
    h) Such other matters as may be prescribed.

The Directors' Responsibility Statement shall state that –

i) In the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;
ii) The directors had selected such accounting policies and applied them consistently and made judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period;
iii) The directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;
iv) The directors had prepared the Annual Accounts on a going concern basis; and
v) The directors, in case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively. The explanation of 'internal financial controls' for the purpose of this section means policies and procedures adopted by the company for ensuring orderly and efficient conduct of its business, including adherence to company's policies, safeguarding of its assets, prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and timely preparation of reliable financial information;
vi) The directors had devised proper systems to ensure compliance with provisions of all applicable laws and that such systems were adequate and operating effectively.

The BOD's report and any annexures thereto under sub-clause (3) shall be signed by its Chairperson, if he is authorised by the Board and where he is not so authorised, shall be signed by at least two directors, one of whom shall be the MD, or by the director where there is one director. A signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of –

a) Any notes annexed to or forming part of such financial statement;
b) The Auditors' Report; and
c) The Board's Report referred to in sub-clause (3).

If a company contravenes the provisions of this clause, the company shall be punishable with fine ranging between Rs.50,000/- to Rs.25,00,000/- and every defaulting officer of the company shall be punishable with imprisonment for a term extendable upto 3 years or with fine,ranging between Rs.50,000/- to Rs.5,00,000/- or with both.

CONCLUSION

The Companies Act, 2013 prescribes onerous duties and responsibilities for company director and also for the CS. Contraventions will be visited with penalty of fine as well as imprisonment. Thus, it is necessary to know the changed provisions of the law, and it is also necessary to constantly update such knowledge. To avoid prosecutions resulting from unintended lapses, persons associated with the company management need to be alert, updated and ready to learn more. CS

The Companies Act, 2013 – Accounts and Audit

Preparation of accounts and audit thereof are important compliances mandated by the Companies Act and these involve elaborate compliances. The Companies Act, 2013 which ushers in an altogether new company law regime in India has made substantial changes in the law relating to accounts and audit. This article comprehensively describes the new provisions.

INTRODUCTION

The law relating to administration of Companies, dates back to 1866 when the Indian Companies Act was enacted. Thereafter, the law was re-enacted with changes in 1882, 1913 and 1956. Since then, about fifty six years have passed and in the meanwhile vast changes had taken place in the national and international economic environment and growth of economy of the country as well as the world, especially in Europe and USA. Changes have taken place in the laws governing the Corporate Sector, whether engaged in business or commerce or engaged in social activities. The Central Government took the initiative to thoroughly revamp the Companies Act in the year 2004. This exercise has now fructified. A new Act called the Companies Act, 2013 at last has emerged. The main purpose seems to be to meet with the changed national and international economic environment and to further accelerate the growth and expansion of the economy with accent on more accountability and transparency.

This article intends to limit its examination to the Chapters of the Companies Act, 2013 relating to 'Accounts and Audit. These are dealt with in Chapter IX on 'Accounts of Companies' consisting of sections 128 to 138 and Chapter X dealing with 'Audit and Auditors' consisting of sections 139 to 148. In Companies Act, 1956 these are dealt with in Sections 209 to 223 under the heading 'Accounts' and Sections 204 to 233B under the head 'Audit'. No attempt is therefore, made in this article to repeat the possible alternatives that could have been chosen but to confine to explain the exact implications of the amendment and how best these could be complied with. *However, where ambiguities still persist, these are brought forth so that appropriate clarifications could be provided by the Authorities concerned. In the process, the additions, modifications and omissions, if any, are dealt with since the readers would be already aware of the existing provisions concerning 'Accounts and Audit'.*

Changes in the definitions

(i) The definition of 'Associate Company' perhaps carries the same meaning as in Accounting Standard AS 23 but also includes 'Joint Venture'.

(ii) Body corporate : Though section 1(4) of the new Act states that the new Companies Act is s applicable to those bodies Corporate incorporated by other Acts, the definition of body corporate excludes those body corporates which are notified to be excluded from the application of this Act

(iii) 'Books and Paper' or 'Books of Account' or 'Document' now

> There is a rider as to 'the time period' for which the Books of Account are to be kept which is laid down to be 8 years in the normal course. The Books of Account consist of the whole gamut of records pertaining to the transactions undertaken by the Company. However, the Act states that Books of Account has to be kept for a longer period as may be directed by Central Government when an investigation has been ordered. It is not clear how a Company can keep the records for a long period when the Investigation takes place after the period of 8 years has already lapsed.

includes those matters included in the definition whether maintained manually or in electronic form.

(iv) The new definition 'Branch Office' is ' any establishment described as such by the company'. However, the earlier definition contained in Section 2(9) of the Act of 1956 defined branch office also to include (a) any establishment carrying on either the same or substantially the same activity as that carried on by the head office of the Company OR (b) any establishment engaged in the production, processing or manufacture but does not include any establishment specified in any order made by the Central Government. *Therefore, it is not clear as to whether or not a Company is free to describe an establishment described in either (a) or (b) above as Branch. This perhaps could not be the intention.*

(v) The definition of 'Company Secretary' is now restricted only to those who can be described as such under the Company Secretaries Act 1980. The flexibility of appointing others who had the prescribed qualification as earlier notified under the previous Act is no longer available.

(vi) 'Cost Accountant' unlike the definition of Chartered Accountant under Section 2(17) *has not been defined as having a Certificate of practice.*

(vii) The definition of the word 'deposit' is now linked with the definition contained in the RBI Guidelines regarding 'deposits'.

(viii) The definition of Financial Statement, would now include besides the Balance Sheet, Profit and Loss Account or Income and Expenditure Account also a Cash Flow Statement as well as any explanatory notes attached to any of the items included in the definition of Financial Statement. *This would mean that even if Stock Exchange Regulations may not be applicable to a Company, it would still be obligatory to prepare a cash flow statement as part of Financial Statement.*

(ix) Internal Financial control means the polices and procedures adopted by the Company for ensuring the *orderly and efficient conduct of its business including adherence to Company's policies, safeguarding the assets the prevention and detection of frauds and errors, accuracy and completeness of the accounting records and timely preparation of financial statements.*

(x) Now, a 'financial year' could only be from 1st April to 31st March of a year. The choice to adopt any other cycle of a year is not permissible. Therefore, a Company registered in the middle of the year i.e. 1st April to 31st March has to close its accounts at the end of 31st March, however short the intervening period be.

(xi) A foreign Company would be deemed to be an Indian Company for the limited purpose of the new Act even *if it does not have a place of business in India nor conduct its business through an agent in India but through electronic mode. So for purpose of compliance with accounts and audit foreign Companies have to prepare a set of Financial Statements incorporating the transactions they have conducted in India and file a return to the Registrar of Companies. They will have also to appoint a Chartered Accountant as defined in the new Act to conduct an audit of the Financial Statements. Such an Auditor will have access to all the records, books and accounts pertaining to the transactions conducted in India.*

(xii) The term 'Free reserves' has been clarified as to what it would constitute. This clarification is necessitated since dividends can be declared out of 'Free Reserves' only. *Thus the amounts involved in the following items will not be defined to be free reserves* even if the amounts are shown as reserves or surplus or in the Equity portion in the Balance Sheet (a) unrealized gains, notional gains or revaluation of assets and (b) *any amount involved in fair valuation of assets and liabilities of the Company.*

(xiii) The definition 'Net Worth' is stated to include the aggregate value of the paid up share capital and all reserves created out of profits but does not include reserves created out of revaluation of assets, write back of depreciation and amalgamation.

In the case of a Company which is neither a listed Company nor falls under the class or classes of Companies, there is no obligation to rotate the Auditors at any time. Similarly the rotation of audit Partner within the Firm will also not be applicable.

However the definition does not exclude the amounts accounted for due to fair valuation of assets and liabilities are also unrealized whereas the reserves created out of revaluation has been excluded even though it is also not realized.

(xiv) Related Party as listed in section 2(76) mostly centres round the definition contained in Accounting Standard 18 and may lead to either 'Control' or 'significant influence' on the concerned body. The definition contains a 'clause' for eventual 'other relationships' to be prescribed and includes a person on whose advice, directions, or instructions a Director or a manager is accustomed to Act.

(xv) The definition of "Relative" includes, besides Husband and Wife and members of HUF, one person related to the other in such manner as may be prescribed, leaving the definition wide open. When notified, it will affect the definition of 'related party' also. The definition of relative in Accounting Standard 18 is, the spouse, son, daughter, brother, sister, father and mother in relation to the individual concerned. It is hoped that the notification would confine to this limited list of relatives.

(xvi) The word 'remuneration' has now been defined to include all facilities treated as perquisites under the Income Tax Act, 1961. It means that any facility though could be expressed in monetary terms would not be regarded as remuneration if the same is not treated as a 'perquisite' under the Income Tax Act, 1961.

Accounts of Companies :Major changes

Chapter IX containing sections 128 to 138 deals with 'Accounts of the Companies' and Chapter X containing sections 139 to 148 deals with 'Audit and Auditors'. The salient features of additions, alterations, modifications and deletions are discussed in the following paragraphs.

There is a rider as to 'the time period' for which the Books of Account are to be kept which is laid down to be 8 years in the normal course. The Books of Account consist of the whole gamut of records pertaining to the transactions undertaken by the Company. *However, the Act states that Books of Account has to be kept for a longer period as may be directed by Central Government when an investigation has been ordered. It is not clear how a Company can keep the records for a long period when the Investigation takes place after the period of 8 years has already lapsed.*

The terminology for the annual accounts (vide section 129) has been collectively christened as Financial Statements consisting of (a) Balance Sheet (b) Statement of Profit and loss Account and (c) Cash flow Statement. The format of the Financial Statement has been prescribed in Schedule III which replaces Schedule VI of the Companies Act 1956. By and large, the format is the same as was provided in the revised Schedule VI recently notified. However, a one person Company need not prepare cash flow statement. There was no requirement for the preparation of cash flow statement for the fact since neither the stock exchange nor Accounting Standard 3 in certain situations warranted drawing up of the cash flow statement. The exception provided in section 2(40) for dispensing with Cash flow statement is in respect of one person Company. *However, it is not certain as to whether the requirements of Accounting Standard 3 will supersede the provisions of this clause granting exception only to one person Company or the provisions of the Act and consequently, other bodies contemplated in AS 3 would also be exempt.*

Section 129 which concerns with the Financial Statement only states that the Financial Statements shall give a true and fair view of the state of affairs of the Company and comply with the Accounting Standards notified under section 133 provided that the items in such Financial Statements shall be in accordance with the accounting standards. *Therefore, it appears that the requirement of the law as contained in the new Act as opposed to the Accounting Standard being a subordinate law should prevail. When the Cash Flow Statement is required to be made, then such a statement should conform with the requirement of that accounting standard. When an exemption is provided, there would be no need with compliance of this standard.*

There is no provision for 'Individual Companies' to seek exemption from disclosure of the required particulars in the Financial Statement as provided for in Section 211(4) of the Act of 1956, but the Central Govt. can grant such exemption to a class or classes of Companies on an application made by such class or classes or by itself *suo motu*.

Besides consolidation of subsidiaries' Accounts, section 129 also requires that a separate statement containing the salient features of the Financial Statement of its subsidiaries in such form as may be prescribed should also be attached with the consolidated Financial Statement. *Schedule III contains the general instructions for the preparation of consolidated Financial Statements but does not prescribe any specific manner in which it is to be done. It is not clear as to whether compliance with the requirement of Accounting Standards on 'Consolidated Financial Statement i.e. AS 21' which has already been notified would suffice.*

The word 'subsidiary' for the limited purpose of consolidation would include Associate Company and Joint Venture. Perhaps even without this clarification, Accounting Standards 23 and 27 deal with Accounting for investment in Associates in consolidated Financial Statements and financial Reporting of interest in joint ventures.

The punishment for the failure to keep Books of Accounts, has been increased to 1 year imprisonment or fine of Rs. 50,000 to Rs. 5,00,000.

The requirement of attaching all the documents viz. Directors Report, Audited Accounts, Auditors Report and other Reports is not made compulsory though all these are to be placed before the annual general meeting and distributed to persons concerned.

As already stated Financial Statements should cover a period of 12 months beginning from 1st April to 31st March only and no other period.. There is no provision for a period beyond 31st March. *The definition clause of financial year i.e. section 2(41) permits an exception only to those Companies which are holding Companies or subsidiaries of a Company incorporated outside India and the laws of that country requires the Financial Statements to be consolidated on a date different from 31st March.* They can apply to the National Company Law Tribunal (to be established under Section 408) for adopting a different financial year. *The Ttribunal may permit the request only if it is satisfied for the necessity to give such permission.*

It is not clear as to why this exemption has been given to the specified Companies since even now, when most of them follow the Calendar Year, they have to necessarily prepare the Financial Statement separately covering the period from 1st April to 31st March for the purpose of filing of their return under Income Tax Act since that Act affords no flexibility for the Companies to file the return covering a different period.

The Financial Statements have to be authenticated as per the modified law by (a) the Chairman of the Company if so authorized by the Board or (b) by two Directors out of which one should be the Managing Director, if any and (c) Chief Executive Officer, if any, if he is a Director in the Company AND (d) Chief Financial Officer, Company Secretary, if appointed.

The word 'if appointed' perhaps would be applicable to the 'Chief Executive Officer', 'Chief Financial Officer' and 'Company Secretary' since there is no provision for compulsory appointment of a 'Chief Executive Officer', a 'Financial Officer' and the appointment of a Company Secretary would be necessitated only under certain circumstances.
As regards reopening of either the Books of Account or the Financial Statement, *the new provision vide section 130 gives the option only when* application is made to the Tribunal by either (a) the Central Government (b) the Income Tax Authorities (c) Securities Exchange Board (d) any other Statutory Regulatory Body or (e) any other person concerned and the 'tribunal' or 'a Court of Competent Jurisdiction' passes an order permitting such revision. Perhaps 'any other person concerned' may include the Company itself besides other interested persons. However, *the cause for* the application should be *to reopen* the Financial Statement or the Books of Account could *relate only to the following reasons (a) the earlier year's accounts were prepared fraudulently or (b) the affairs of the Company were mismanaged.*

However, section 131 deals with cases of *revision* of Financial Statement for the limited purpose of complying with the requirement of section 129 which deals with preparation of Financial Statement and section 134 which deals with the contents, authentication and various other documents that are required to be prepared and presented to the shareholders of the accounts earlier drawn were defective and did not fully comply with the requirements after having obtained approval from the Tribunal. The corrections should however be limited only to rectify the omissions to comply with the relevant Sections and should not be used to corrections unrelated.

As regards rectification of accounts due to mistake (not arising out of fraud or mismanagement) for the limited purpose of complying with the technical requirements of the laws like Income Tax Act etc. perhaps it may still be possible to rectify the same (without obtaining the approval of the Tribunal) as was permitted by the Department of the Company Affairs by its Circular No. 1/2003 dated 13.01.2003 bearing the number 17/79/2002 (LV).

Changes in the manner of appointment of Auditors

Chapter X of the Act deals with matters connected with the Auditors as regards their qualification, disqualification, their tenure of office, the manner of their appointment, removal, remuneration, powers, duties, and punishment in cases of failure to perform their duties. The Chapter also deals with audit of 'cost items' in respect of specified Companies.

Section 139 requires that in the case of listed Companies or companies belonging to such class or classes of Companies an Auditor whether an 'individual' or a 'Firm'(including Limited Liability Partnerships) when appointed or re-appointed can continue in office for five consecutive years provided his re-appointment is confirmed at each of the annual general meetings .

In the case of a firm, it can be appointed for a second term of five years following the procedure described above. In the case of an individual, the initial term is only for five years and he cannot be re-appointed in continuation of his first term without interruption. Both in the case of an individual and a firm the eligibility for reappointment is denied for the next five years.

The Central Government has assumed powers as to how exactly the retiring Auditors could be rotated. Perhaps it is the intention to place further restrictions on the re-appointment of the Auditors once

they complete their first term of appointment. Specified companies have been given a period of three years to comply with the requirements of rotation. It is not clear as to whether existing Auditors, if they had already completed 5 years as Auditors continually, will have to be rotated or the period of rotation would start only from the commencement of the new Act. Similarly it is not clear whether the Auditor who at the commencement of the Act had not completed five consecutive years can continue for the balance period before being rotated. Keeping in view of the fact that rotation is contemplated only after an auditor has functioned as such for a period of five years, this should be possible.

When a Firm is appointed as Auditors, the members (of the listed Company or class or classes of Companies) in the Annual General Meeting either at the time of appointment or at the time of renewal, *can specify that the Partners, within the Firm along with the set of the team with him should be rotated after a certain interval or the audit should be conducted by more than one Auditor. The meaning of the words 'more than one Auditor' is not clear as to whether by more than one 'audit Partner' within the Firm or the audit should be conducted jointly by two or more Auditors whether individually or by Firms or a combination of both.*

The Act for the first time recognizes Limited Liability Partnership to be appointed as Auditors. *Only a Chartered Accountants in practice who is a Partner in an LLP can certify the Audit Report.*

In the case of a Company which is neither a listed Company nor falls under the class or classes of Companies, there is no obligation to rotate the Auditors at any time. Similarly the rotation of audit Partner within the Firm will also not be applicable.

For non appointment of another Auditor in place of a retiring Auditor or moving a Resolution not to re-appoint the retiring Auditor before the expiry of his term a Special Resolution would be necessary.

For removing an Auditor before the expiry of his term in addition to the Special Resolution (instead of an Ordinary Resolution as contemplated by section 224 (7) of the 1956 Act) the previous approval of the Central Government would be required. *It is not understood as why the emphasis of obtaining a 'Special Resolution' of the members as opposed to 'Ordinary Resolution' would be necessary. This may perhaps be to give a higher security to the independence of Auditors as well as increased rights to minority shareholders.*

The Tribunal is authorized either suo motu or on an application from Central Government or the person concerned to direct the Company to change the Auditors if it is satisfied, that if he or it has Acted in a fraudulent manner or abetted or colluded in any fraud. Such an Auditor will not be eligible for appointment as Auditor for a period of 5 years. However, in the case of application from Central Government, *the Tribunal can itself appoint another Auditor instead of asking the Company to appoint another. It is not clear as to how long such an Auditor can continue.*

The liability, as regards disability for being appointed as Auditor, would be applicable not only to the individual concerned but also to the Firm or every other Partner who Acted in collusion.

Vide Section 141 (3) the following, whether individual or Firm or a relative are disqualified for being appointed as auditors:

(a) A person holding securities of the 'Company' exceeding the face value of *Rs. 1000 or such sum as may be prescribed* or indebted to the Company, or given guarantee or provided security to any person indebted by the Company. A relative (either of the individual or firm) also, can only hold securities or interest to the extent of Rs. 1000 of the face value [vide section 141 (d)].
(b) *A person who has any business relationship with the Company whether directly or indirectly i.e. through perhaps 'relative'. The Company for the purpose of (a) & (b) includes not only the Company for which he has been appointed as Auditor but would include its holding Company or any of its subsidiary or an Associate [vide* section 141*(c)] .*
(c) A person convicted by a Court for a period of 10 years for any fraud [section 141 (h)].
(d) If any other person or Firm or such other body in which either the individual or Firm is either a Partner or associated *at the time of appointment is rendering consulting or other specified services as contemplated in section 144. Consequently the Auditor cannot by himself render such services to the Company [vide Section 141(4)].*
(e) A person who is an 'Officer' or 'Employee' of the Company or is a 'Partner' or is 'in the employment' of an 'Officer or Employee of the Company' or 'a relative of a Director' or 'himself employed as a Director or as a Key Management Personnel' in the Company [Section 141 (b), (c) & (f)].
(f) *A person who is in full time employment elsewhere or if a person or Partner of Firm holds appointment as Auditor in more than 20 Companies.*
(g) A body corporate other than an LLP.

As regards the disqualifications restricting the appointment of Auditors to 20 Companies concerned, Clause 141(g) does not make any distinction between Companies having paid up share capital of Rs. 25 lacs or more within the number of 20 nor between Public or Private Limited Companies. Therefore, the restrictions of 20 Companies will also include Private Companies at the time of appointment of Auditors.

The reference to a 'Partner' of a Firm in section 141(g) instead of 'Partner in a Firm' as is contained in Section 224 of the Companies Act 1956 *perhaps means that the limit of 20 is in relation to each Partner of the Firm even though an appointment of a Firm as Auditor is made in the name of the 'Firm' and not in the name of*

any individual Partner in the Firm.

Sub Section(1B) of Section 224 of the present Act of 1956 which limits the number of Companies for which the same Auditor could be appointed, states that the Section will come into force only *on and from the financial year next following the commencement Companies (Amendment) Act 1974 and sub Section (c) states that for the purpose of the Company to comply with the provisions of sub section (1B) the Auditor concerned, within sixty days, to intimate as in which of the Companies the Auditors would like to continue or discontinue as Auditors. However there is no corresponding provision in* section *141 or elsewhere in the Act since the limit of 20 Companies is now to include private Companies also.*

According to section 141, an Auditor who holds such appointment as the Auditor either in a holding or a subsidiary of another subsidiary can be appointed to the other Companies connected in the above manner even if he is disqualified to be appointed as Auditor by virtue of section 141(3). *Section 226 (4) of the 1956 Act contained a prohibition in such cases.*

As regards the Auditors reporting responsibility is concerned (vide Section 143) practically these are more or less same except for that fact that certain additional matters, as may be prescribed, are also to be answered or Reported upon. These are

(a) In respect of such class or description of Companies, as may be prescribed in consultation with National Financial Reporting Authority, a statement on such matters that are prescribed.
(b) The Auditor is required to Report separately and immediately to the Central Government if he has reasons to believe that an offence involving a fraud is being or has been committed against the Company by officers or employees of the Company.

The word 'being' perhaps means that a fraud has already been committed and is still continuing since an Auditor cannot conclude whether a 'fraud' is 'being committed' unless the Action has resulted in an actual fraud. He cannot, merely on suspension, report that a fraud is 'being' committed.

Section 147 mentions about the punishment for defaults committed by the Auditors as regards their responsibilities. The normal punishment is a fine between Rs. 25,000 and Rs. 5 lacs. However, if the Auditor is found to have knowingly or willingly with the intention to deceive the Company or its shareholders or its creditors or tax authorities committed any office, the punishment will be imprisonment upto 1 year and fine between Rs. 1 lac and Rs. 25 lacs.

The provisions of this Section will apply *mutatis mutandis* equally to 'Cost Accountant' appointed under section148 and to Company Secretary in practice' appointed under section 204. The word *mutatis mutandis* perhaps means 'in every aspect'. It is presumed that the Reporting responsibilities mentioned in this clause would be applicable with regard to matters they are supposed to examine under Section 148 or 204 as the case may be.

The Auditor is required to sign the Auditors Report. *The 'adverse remarks' contained in the Auditors Report has to be read in the Annual General Meeting where he is now compulsorily to be present* or be represented by another person who is also otherwise eligible to be appointed as Auditor in his individual capacity. A Chartered Accountant with a certificate of practice connected with the Firm can represent.

The Auditor, whether Chartered Accountant or Cost Accountant or a Practising Company Secretary will be liable under section 147 for contravening the provisions of sections 139 to 146 concerning 'Audit and Auditors' for punishment to a greater extent than contemplated under the Act of 1956 both in respect of (a) the Company or (b) its Officers or (c) the Auditors. In the case of any Officer of the Company imprisonment may extend to 1 year or a fine between Rs. 10,000 to Rs. 1 lac.

The special audit contemplated under Section 233A of the Act of 1956 has been omitted.

As regards Cost Audit the following changes have been brought about :

(a) *No approval of the Central Government is required.* However in the case of Cost Audit of 'bodies created under special Act' the concerned body is to be consulted by the Central Government before ordering Cost Audit.
(b) The words ''production, processing, manufacturing or mining Activities' have been changed to "production of such goods or providing such services as may be notified". *The word 'such' used against 'goods' and 'services' is all embracing and is therefore not likely to make any change in the existing situation.*
(c) No part of the Cost Audit Report is to be circulated to members.