



Confederation of Indian Industry

The Companies Act, 2013 & The Companies Rules, 2014

**Notification of Sections and Rules
under Companies Act, 2013**

Recommendations



Confederation of Indian Industry

Notification of Sections and Rules under Companies Act, 2013

Suggestions / Clarifications Required

With the notification of multiple sections of the new Companies Act, 2013 (“**new Act**”) and subordinate legislation in the form of rules, companies are faced with the challenge of complying with the new legal regime in a matter of a few days. This is because most of the sections and rules thereunder were notified in the last week of March, 2014 - to be in effect from 1 April, 2014.

CII has been in receipt of numerous views and requests for revisions / clarifications of complying with the new requirements. A detailed note on such views is given herebelow with an earnest request to the Ministry of Corporate Affairs to review / clarify them.

FORMATION OF COMPANY

1. Requirement - Private Company - Subsidiary of Foreign Company

By combined reading of Sections 2(71) and 2(87) of the Act, it is not clear whether a private company which is a subsidiary of a foreign body corporate will be deemed to be a public company and the law will be applicable to it as such. Provisions akin to Section 4(7) of the Companies Act, 1956 also does not exist under the new Act.

Suggestion

Section 2(20) of the 2013 Act defines the term “company” to mean “a company incorporated under the Companies Act 2013 or any previous company law.” Accordingly, a company, which is incorporated under the relevant legislation of a foreign country, will not qualify as a “company” under the 2013 Act. The proviso to section 2(71) states 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.”

Section 2(87) defines the terms “subsidiary” in relation to any other company. The sub-section states that for the purposes of such definition, the expression company includes “body corporate”.

Under the 1956 Act, the issue regarding companies incorporated outside India is dealt with under the section 4(7). The section read as below:

“A private company, being a subsidiary of a body corporate incorporated outside India, which, if incorporated in India, would be a public company within the meaning of this Act, shall be deemed for the purposes of this Act to be a subsidiary of a public company if the entire share capital in that private company is not held by that body corporate whether alone or together with one or more other bodies corporate incorporated outside India.”

A similar provision does not exist under the 2013 Act. This has resulted in an ambiguous position with regard to private companies which are subsidiaries of foreign public companies. A “foreign company” is not a “company” under the 2013 Act as used in the proviso to section 2(71). Hence, the proviso to section 2(71) is not triggered. Under this argument, a private company, which is subsidiary of foreign company, will always be a private company. We believe this is the intent of the new 2013 law and the benefit of private limited status will be available to subsidiaries of foreign companies.

Apparently, the concept enshrined in section 4(7) of the 1956 is therefore not separately contained in the 2013 Act.

This issue impacts many key requirements under the new Act e.g., requirements concerning Woman Director, Independent Directors, Audit Committee and Nomination & Remuneration Committee (NRC) as well as auditor rotation.

MCA should clarify this position so that there is no ambiguity around the continuing availability of the protection [similar to the earlier protection provided under the erstwhile Section 4(7)] in the new Act

2. Requirement – Format of Memorandum and Articles of Association

Per the old Act, Memorandum of Association was to be divided into three parts viz. main, ancillary and other objects. The format of MOA is prescribed under this act in Table B to E of the Schedule I. (Section 13). In the Companies Act 2013, the bifurcation of the object clause into main, ancillary and other objects has been dispensed with. New format as per Table A to E of Schedule I of the act are prescribed. (Section 4)

Suggestion

It needs to be clarified whether Memorandum of Association and Articles of Association have to be amended to conform to the new formats prescribed under the new Act

3. Requirement – One person Company

- Rule 3(1) provides that only a natural person who is an Indian citizen and resident in India shall be eligible to incorporate OPC
- No person shall be eligible to incorporate more than one OPC or become nominee in more than one such company
- OPC to compulsory convert itself into public or private company in certain cases. Where the paid up share capital of an OPC exceeds fifty lakh rupees or its average annual turnover during the relevant period exceeds two crore rupees, it shall cease to be entitled to continue as a One Person Company.

Suggestion

- Body Corporate and Foreign Citizen resident in India should also be allowed to form OPC subject to fulfilling some conditions. Allowing only natural persons and Indian Citizen to make use of OPC provisions is too restrictive.

- Restrictions on formation / becoming nominee of not more than one OPC should be increased to 5 as it was in draft rules. In draft rules, the maximum cap/ ceiling put on an individual incorporating One Person Company (OPC) was Five (5), but in final rules, the limit has been reduced to One (1). Which means an individual can only incorporate and maintain only one OPC, which is restraining from carrying on more than one business in individual capacity.
- Requirement of OPC to convert its status upon reaching the financial caps stipulated under the rule should be removed or increased. The requirements are substantially narrowing down the scope of One-Person Company to be practically used as a vehicle of facilitating business only for start-ups businesses in India.

4. Requirement - Shifting of Registered Office within the same state

Rule 28 read with Section 12 provides that shifting of registered office is not be allowed if any inquiry, inspection or investigation has been initiated against the company or any prosecution is pending

Suggestion

It needs to be explained that the restriction on shifting of registered office shall not apply in case the inquiry, inspection or investigation has been completed. It is not specified on completion of such inquiry, inspection or investigation, restriction will be removed or not

5. Requirement - Alteration of Memorandum by change of name

Rule 29 read with Section 13 provides that change of name shall not be allowed to a company which has defaulted in filing its annual returns or financial statements or any document due for filing with Registrar or which has defaulted in repayment of matured deposits / debentures / interest thereon

Suggestion

It should be clarified that once the defaults are rectified then the Company is allowed to change its name under the provisions of the act

6. Requirement - Shifting of registered office from one state to another

Rule 30(3) says that there shall also be attached to the application an affidavit from the directors of the company that no employee shall be retrenched as a consequence of shifting of the registered office from one state to another state and **also there shall be an application filed by the company to the Chief Secretary of the concerned State Government or the Union territory.**

Sending notice through Registered Post with acknowledgement due in case of company Shifting its registered office from one state to another is prescribed

Suggestion

There is no need to bring stipulation of labour laws within the purview of the Companies Act 2013. The Ministry should provide clarification on the application to be filed by the company to the Chief Secretary of the concerned State Government or the Union territory. Generally, service agreements entered into by a company with its employees contain a clause to the effect that their employment will

be transferable. In any case, if employees are at all required to be retrenched in the course of shifting of Registered Office of a company, the provisions of the Industrial Disputes Act, 1947 would apply.

The same should be allowed through ordinary post, hand delivery, e-mail and other modes also. In the present scenario, e-mode, ordinary post, hand delivery should be used to provide flexibility to companies.

7. Requirement - Copies of Memorandum, articles etc given to members

Per Rule 34, providing copy of MOA, AOA, every resolution and agreement covered under section 117(1) on being requested by member has been prescribed

Suggestion

Rule 34 in relation to section 17 should be deleted as it is a complete replica of section 17. Both section and rules provides the same thing and its of no use to copy same language in rules as defined in the act

DEFINITIONS

8. Requirement – Merchant Bankers as Officer in default

The definition – “Officer who is in default” also includes registrar and share transfer agents and merchant bankers (in case of issue or transfer of shares). Merchant Bankers are only responsible for co-ordination of the post issue work and not the actual work of the Registrars.

Suggestion

The scope and extent of coverage under transfer of shares needs to be clarified. Also who shall be responsible/officer in default in case of Merchant Bankers, with respect to issue or transfer of shares needs to be clarified.

9. Requirement – Director as Related Party

The Companies (Specification of definitions details) Rules 2014 - Rule 3 – deems related Party to be a director or key managerial personnel of the holding company or his relative with reference to a company. In effect, this rule implies that even Independent Directors (ID) who are common between Holding company and Subsidiary would cease to be independent directors in the subsidiary in terms of this Rule read with Section 149 (6)(b)(ii) of the Act. In this regard, it maybe noted that Clause 49 of the Equity Listing Agreement provides for representation of a Holding company Director on the Board of a Material Subsidiary. From governance perspective it would be desirable to treat this Director as independent on the board of material subsidiary too. Further it would enable constitution of various committees like Audit Committee & Nomination & Remuneration Committee in compliance with the Act, without a very large Board.

Suggestion

Accordingly we represent that Rule 3 exclude Independent Directors on Holding company specifically; there are adequate safeguards against transactions with IDs through the mechanism of Section 149(6)(c), to ensure their continued independence.

DIRECTORS

10. Requirement - At least one director in India

It is provided that every company shall have at least one director who has stayed in India for a period of not less than 182 days in previous calendar year

Suggestion

It is recommended that private companies be exempted from meeting these requirements to avoid any practical difficulties since such companies may have two directors and if due to genuine business requirements if they stay out of India for more than 182 days, than it will be difficult for such private companies to comply with these requirements.

Since the section requires every company to have one director resident in India for a period of 182 days or more in the previous calendar year, it can cause hardship particularly for foreign companies as they may not be able to find a resident director at the time of incorporation of an Indian subsidiary. Therefore, we suggest that in the first year of incorporation this condition may be waived or suitably modified to allow companies to have first directors who previously may not have been residents in India but will be residents for at least 182 days a year from the date incorporation of the Company.

Further, as the Companies Act 2013 measures various aspects on a financial year basis, we recommend that the criteria for residency may be measured on a financial year basis rather than calendar year.

11. Requirement – Woman director

Every listed company and every other public company having (a) paid-up share capital of one hundred crore rupees or more or (b) turnover of three hundred crore rupees or more shall have a woman director..

Suggestion

The thresholds for the requirement for woman director for unlisted companies should be reviewed and considerably enhanced. Mandating gender diversity may not be supported by a practical viewpoint in India. Board power needs to be enriched by bringing together the right mix of members with the desirable skills required for the efficient running of the business. An inclusive Board would be one which has a diversity of skills, thought, experience, knowledge, understanding, perspective and age. Board members are leaders who evolve in their respective fields to be fit for the hierarchical role in the organization. Mandating a legal requirement for this may pose a challenge since one cannot be fit for a Board member's role by dint of law since it has to come through the right education, skill, work experience, training and expertise in the business.

It is also provided that any intermittent vacancy of a woman director shall be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy whichever is later. The period of 3 months is very short for finding the right candidate since quality of board is critical - there should be same rigor for women as for other directors. Also the culture needs to be embedded into the organization so that diversity is nurtured throughout the

hierarchy and not followed only at the director level. The period may thus be enhanced to at least 6 months.

12. Requirement - Committees

All listed companies and the following classes of companies shall constitute an Audit Committee and a Nomination and Remuneration Committee of the Board-

- (i) all public companies with a paid up capital of ten crore rupees or more;
- (ii) all public companies having turnover of one hundred crore rupees or more;
- (iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

Unlisted companies falling within the threshold will now be required to constitute an Audit Committee and Nomination & Remuneration Committee.

Suggestion

MCA should review the applicability of this provision to the unlisted companies. If complete dispensations of unlisted companies are not possible, at least the threshold should be significantly increased upward. The thresholds specified for the applicability of this provision to public limited companies are painfully low.

For others, a window of at least 1 year should be provided to comply with the provisions of Section 178 as provided under section 149(4).

13. Requirement - Board Evaluation

While Section 178 provide that the Nomination and Remuneration Committee shall carry out evaluation of every director's performance, the code of conduct in Schedule IV provides that the performance evaluation of independent directors shall be carried by entire board

Suggestion

The methodology of evaluation should be left on to the corporates. Nomination Committee / the Board should be responsible to ensure existence of proper evaluation methodology. The contradictions in the language used in Section 178 and the Code should be removed.

INDEPENDENT DIRECTORS

14. Requirement – Eligibility - Definition of pecuniary interest

The new regime prescribes appointment of Independent Directors under section 149 of the Act on the Board of the companies which fall under the categories given under sub-section (4) of section 149 read with Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

Sub-section (6) of section 149 lays down various eligibility criteria for determining whether a director is independent or not. The criteria given under clause (c) of sub-section (6) of section 149 mention that

an independent director in relation to a company shall mean a director who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year.

The term 'pecuniary' has not been defined under the Act, Rules thereof or in the revised Listing Agreement. This leads to confusion over determination of what quantum of pecuniary interests should be considered. Pecuniary transactions can work both ways, firstly, a director purchasing any product or receiving any services from a company and secondly, the company receiving any services from the director. This will give rise to few absurdities like having directors on the Board of companies which are in the business of Fast Moving Consumer Goods like soaps, toothpastes, food items, etc. which are procured or used by any individual in their routine life for trifling purposes. Such transactions being pecuniary in nature will come under the ambit of this sub-clause, making it difficult to appoint independent directors on the Board of any company.

Suggestion

It is requested to suitably provide threshold limits considering the concept of "materiality". Also the nature of pecuniary transactions or relationships which may be considered while determining the status of a director with reference to his independence should be provided. In fact, the remuneration apart from director's remuneration, if any should only be considered. For example, directors receiving remuneration as a director from holding company should not be considered as having pecuniary interest while considering his appointment in a subsidiary company. If no such clarity is provided on the same, it would result in great hardship to the directors and the companies as even transactions involving monetary interests however minuscule they may be will be hit by the condition given in clause (c) of sub-section (6) of section 149, hence disqualifying the director from being independent.

Also, under clause 49(V)(A) of the Listing Agreement, at least one independent director on the Board of Directors of the holding company shall be appointed as a director on the Board of a material non listed Indian subsidiary company. In the process of complying with the requirements under the Act pertaining to independent directors, compliance with the Listing Agreement provision stated above will be jeopardized as such independent director receiving director's remuneration from the subsidiary will result in him losing his independence in both the companies.

There is already a shortage in the number of independent directors that meet the specific suitable criteria which is unique for each company. Keeping in view the same, it is suggested that the threshold limit of paid up share capital of Rs. 10 crore or more in case of public companies be increased.

Section 149 of the new Act read with the Rules as well as the revised Clause 49 has extended the disqualification of the Independent Directors to consider the pecuniary relationship of their relatives with the Company, its holding or subsidiary or associate, etc. in excess of certain limits which would prohibit their appointment as such (Independent Directors). It would be very cumbersome for the Company to keep a track of the restrictive provision of this Section and hence should be reviewed by the MCA.

Also, a clarification may be issued for treatment of stock options already granted and vested in the existing Independent Directors which are yet to be exercised by them.

15. Requirement - Independent Directors in public companies

The idea of having independent directors in public companies which are not listed is not entirely justified. In terms of Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014, at least 2 independent directors are required to be appointed by public companies having paid-up share capital of Rs. 10 crores or more or turnover of Rs. 100 crores or more or outstanding loans / debentures / deposits of Rs. 50 crores or more.

There has been a substantial change from the Draft Rules. In the Draft Rules, the requirement of an Independent Director was applicable for the Companies having Paid-up Share Capital of Rs. 100 crores or more and Outstanding Loans of Rs. 200 crores & more. However, the Rules provide 3 criteria, namely:

- Paid-up Capital of Rs. 10 crores or more;
- Turnover of Rs. 100 crore or more;
- Outstanding Loans exceeding Rs. 50 crores

Any Public Company fulfilling either of the conditions would be required to appoint at least two Independent Directors. Reducing the threshold limit of Share Capital and Outstanding Loans is not appropriate, as many large Companies would have their Subsidiary Companies which may be fulfilling all the above criteria and hence would be required to have Independent Directors. A few senior executives of the Parent Company are normally deputed as Directors in the Subsidiary Companies, which are Public Companies. It would not be practical for such Companies to have two Independent Directors. Neither the senior executives nor the independent directors of the parent company would qualify to be Independent director of such subsidiary companies. Finding an ID for these relatively small companies would be a challenge.

Further, Rule 6 of the Companies (Meetings of Board and its Powers) Rules, 2014 provides that the aforesaid companies are required to constitute a Nomination and Remuneration Committee of the Board.

Suggestion

It is recommended that the threshold for appointment of independent directors in public companies should be based on the actual public shareholding in such companies in addition to the thresholds of share capital / turnover and the term “Public” must be defined.

Exemption from appointing Independent directors should be granted to those wholly-owned subsidiaries having no external funding either in the form of equity or debt.

Also MCA should clarify the transition time of one year for the companies to comply with the requirement for every listed company and other companies to appoint such number of Independent Directors (IDs) and constitute committees, as provided in the Act/Rule, as the case may be.

Further, companies should also be exempted from constituting a Nomination and Remuneration Committee, considering that it is common practice for a Holding company to appoint its employees as directors / managers of its wholly owned subsidiaries.

16. Requirement – Independent Directors in Joint Venture Companies

Per Section 149, appointment of independent directors and woman director is applicable to joint venture (JV) company if incorporated as public limited company on attaining the threshold for such compliance.

In respect of a Joint Venture Company, where the Indian Company joins hands with a foreign partner and a Joint Venture Company, typically a Private Company is incorporated, wherein there are only two members. Such JV Companies are incorporated for Technology Transfer, for manufacturing speciality Products with collaboration and so on. Such JV Companies, even though incorporated as Private Limited Company being a subsidiary of a Public Limited Company and hence for the purposes of the Companies Act, would be treated as Public Limited Companies. The question is whether the rules relating to appointment of ID would be applicable to such private companies which are, for the purposes of Act, treated as public companies.

Suggestion

The Government should come out with a clarification about the applicability of the provisions of the Companies Act, especially relating to appointment of Independent Directors in such cases. JV companies are governed under the JV agreement, which provisions are incorporated in the Articles of the JV company. These include nomination of certain number of directors by the JV partners. Since all the directors appointed are nominees of the JV partners, exemption to such JV companies from compliance with this section would be required.

The functioning of such Joint Venture Companies is largely monitored by the Joint Venture Agreement, which provides for restrictions on certain executive powers and the Rules governing nomination of Directors by each Party. A concept of Independent Directors is evolving in Corporate India. Considering the sensitivities involved in appointment of Directors in such Companies where a foreign multinational is involved, it would be very difficult for Companies to implement these provisions of appointment of Independent Directors on such Companies. Hence, there should be a specific exemption for Joint Venture Companies, especially those which are registered as Private Limited Companies, from appointing Independent Directors on their Board, even though they are governed by either of the conditions stipulated in Rule 4.

In addition, Infrastructure companies are required to incorporate the Companies as Subsidiaries to comply with the requirement of the Concession Agreement and these companies are highly capitalised and managed by the Holding companies hence it is suggested that requirement of Independent Directors in Infrastructure Companies Subsidiaries/JVs could be revisited. The Listing Agreement criteria, which stipulates appointment of an Independent Director on the Board of the subsidiary company should be followed for appointment of Independent Director on the Boards of Subsidiaries which will also be in sync with the Listing Agreement for listed companies.

17. Requirement - independent directors on cessation of conditions

The proviso to Rule No.4 states that the Company, which ceases to fulfill the conditions specified under the said rules for a consecutive period of 3(Three) years shall not be required to comply with the requirement for appointment of independent director until such time as it meets any of such conditions. There is no rationale for keeping a threshold of maintaining 3 years time period from the

time of non-fulfilment of the criteria for exempting the companies from complying with the requirement of appointment of independent director

Suggestion

A company when it ceases to fulfill the condition for a particular year shall be exempted from complying with the conditions under the said rule with effect from the period of cessation till the next time of fulfillment of the compliance. A Company who does not fulfill the said criteria shall not be made to compulsorily to comply with the requirement of appointment of independent director for the period of three years.

18. Requirement – IDs on Committees

Companies have been given a 1 year period to comply with the provisions requiring appointment of independent directors, if required. However, other provisions in the Companies Act, 2013 like those for an audit committee, which are required to necessarily have independent directors on the committees, have been notified and are applicable as of April 1, 2014.

Suggestion

It needs to be clarified that until April 1, 2015 the requirement to have independent directors on such committees is not applicable, and only becomes applicable once the company is required to appoint its relevant independent directors

19. Requirement - Code for Independent Directors as per Schedule IV

The code appears to be mandatory which is likely to lead to some of the following concerns:

- The code states that an Independent Director shall uphold ethical standards of integrity. However, what would constitute a sound ethical behaviour is not defined therein and is open to interpretation.
- The code refers to appointment of Independent Directors by the Board after evaluating certain attributes. The concern that remains unaddressed is the manner in which companies need to carry out an assessment of the attributes of an Independent Director as specified under ‘manner of appointment’ in the code from the databank maintained by the MCA.
- The code states that the concerns of Independent Director about the running of the company should be recorded in the Minutes of the Board Meeting to the extent they are not resolved. Else, in the event of default on the said event, the Independent Director shall be a party to the default. This, in turn, increases the responsibility/liability of the Independent Directors and would dissuade individuals from taking up appointment as Independent Directors.
- Per the Code for IDs, appointment of Independent Director should be formalised through letter of appointment.

Suggestion

- The code should clearly define the ‘ethical standards of integrity’ or at least some broad Guidelines.

- MCA should ensure that adequate procedure of evaluating the attributes of an Independent Director in the databank are in place to as to comply with the conditions laid down under manner of appointment Schedule IV.
- MCA should consider the role and position of Independent Directors in the Board which is of a Professional nature and review and dilute/exclude this punitive provision.
- Clarity may be provided whether this requirement will be applicable to the existing Independent Directors of the company as well.

20. Requirement - Retirement by Rotation & other misc issues

By way of Section 149 (13) read with Section 152 (6)(viii), while it is clear that any independent director appointed on or after April 1, 2014 is not subject to retirement by rotation, it is not clear whether independent directors appointed prior to April 1, 2014 shall have to be re-appointed at the Annual General Meeting on the expiry of their original tenure under the Companies Act, 1956 or do they have to be retired compulsorily at the first Annual General Meeting to be held after April 1, 2014 and to be appointed afresh for a period of five years under the Companies Act, 2013.

Suggestion

- MCA is requested to clarify that the existing independent directors can continue up to the their original tenure as if the Companies Act, 1956 had been in force and when it comes for retirement by rotation, they shall be appointed for a period of 5 years under the Companies Act 2013.
- The Rules provide for vacancy in the post of independent directors to be filled within 3 months. The Schedule to the Act provides a time frame of 6 months to fill casual vacancies. This is also prescribed by the listing agreement. The Rules have ignored the fact that the appointment method for independent directors is appointment by general meeting and not the board – therefore, it is unlikely that the board will be able to fill a vacancy with 3 months.
- The rules contemplate the personal data of the independent directors being uploaded on the websites. This should be removed from the rules due to privacy and security concerns. Further this is beyond the requirement of Section 150 (1). We recommend that the personal data such as spouse's name, PAN, mobile and phone numbers etc. be removed and that the information should include reference to other business interests and shareholders of directors. The data list should be made available to the authorised body that will provide it to *bona fide* applicants rather than make it publically available on a website. The Rule should be amended accordingly.
- Suitable clarification may be provided under this rule as to whether the requirement of depositing of Rs. 1 Lac with the company under Section 160(1) of the Act will be applicable in relation to the proposal to appoint small shareholders director as well.
- Rationale for requiring a resigning director to furnish reasons for his resignation to the Registrar is not clear. It is not clear whether this is a mere intimation formality to the Registrar or whether the Registrar will have the power to investigate / call for further information on the basis of such intimation.
- Guidance on evaluation criteria to be considered by the Board for evaluation of the performance of the independent directors

KEY MANAGERIAL PERSONNEL

21. Requirement – Appointment of KMP

In terms of Rule 8 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, whole-time key managerial personnel are required to be appointed by every listed company and every other company having a paid-up share capital of Rs. 10 crores or more.

Comment

It needs to be clarified that the requirement is only to appoint one such KMP and not all three whole-time KMPs, listed under Section 203(1) of the Act. It is submitted that companies with paid-up capital of around Rs 10 crores can ill afford the cost of three senior executives. Moreover, there may not be full time work for them. Accordingly, it is submitted that the paid-up capital criterion of Rs. 10 crores should be substantially enhanced.

In the case of a vacancy, Section 203(4) provides a period of 6 months for such vacancy to be filled, however neither the Act, nor the Rules allow for any time period for compliance with the Section, which became effective as of April 1, 2014. It is urged that it be clarified that a period of 6 months is provided for compliance with the Section as well and all KMP are not required to have been in place as of April 1, 2014.

There is also requirement that every listed company shall disclose in the Directors' Report the ratio of Directors' remuneration to the median employees' remuneration, comparison of remuneration of KMP against the performance of the company, comparison with the market capitalisation, details of variable compensation etc. Listed companies will be required to disclose unnecessary information on managerial remuneration.

The final rules clarify that median means the numerical value separating the higher half of a population from the lower half. Assuming a company has three categories of employees, i.e., 1150 lowly paid workers, 550 officers and 299 middle and senior management. The median remuneration would be what employee number 1,000 would be earning, if they were arranged in an ascending or descending order based on their remuneration. In this case, that happens to be a lowly paid worker. The comparison of a lowly paid worker's remuneration with the CEO will reflect a huge disparity and may not give any meaningful information to the users. Comparison of median remuneration of middle and senior management with CEO's salary may still have provided more meaningful information.

Similar disparity may arise in the case of a company which has many branches in countries where remuneration is high. In such cases, inclusion of foreign salaries with Indian workers to determine the median may reflect a distorted comparison.

MCA should reconsider the additional disclosures specified in the Rule 5(1). The disclosures specified in the Rules go way beyond the Act and such disclosures may not be in the interest of the company. The disclosure involves detailed analysis of director remuneration and senior personnel followed by comparison required in the Board's report render several data points cumbersome and subjective. Further these actions would lead to disclosure of sensitive remuneration data in the case of highly skilled personnel for public and competitor view. In this regard, it maybe pertinent to note that salary is based on market conditions and not company performance. **Therefore, this requirement may be dropped.**

Also clarification be provided that for the purpose of disclosure as per Rule 5(2) of remuneration of employees in the Report, the term ‘company’ will not include subsidiary companies. Several times, an employee of the Company may be appointed as an employee of its subsidiaries. The details required to be included in the Board’s Report should be for remuneration received from the Company only, and not from its subsidiaries.

22. Requirement - Penal provisions relating to Managing / Wholetime Directors & Managers

Schedule V to the Act, inter alia, provides that a person cannot be appointed as the Managing / Wholetime Director / Manager of a company, if he / she has been penalised with fine exceeding Rs. 1,000/- for conviction of any offence under various Acts including the Companies Act, 2013.

Comment

In terms of Schedule V, a person is debarred from being appointed as Managing Director / Wholetime Director / Manager, if he / she has been fined any amount exceeding Rs. 1,000/- for contravention of any of 16 different Acts, including the Companies Act, 2013. While the said figure of Rs. 1,000/- has been kept the same as that stipulated under the erstwhile Schedule XIII to the Companies Act, 1956, the penalties under the Companies Act, 2013 have been substantially enhanced even for minor defaults.

Accordingly, it is submitted that the sum of Rs. 1,000/- prescribed under Schedule V for disqualification of a person from being appointed as Managing Director / Wholetime Director / Manager, be substantially enhanced.

LOANS & INVESTMENTS

23. Requirement - Loans to directors

Section 185 provides for loans to directors.

Suggestion

Exemption be provided to private companies from complying with the provisions of Section 185 (as have been provided to holding and subsidiary companies, in certain cases).

Also, guidance on the meaning of “ordinary course of business” as used in Section 185(1)(b) be issued.

The meaning of the term “principle business activities” may also be explained further for clarity. A company may be simultaneously engaged in several businesses – some large and some smaller. It is not clear whether all such activities of the subsidiary company would qualify as its “principle business activities”.

For the purpose of avoiding any unnecessary confusion, it is advisable to provide necessary clarification to the effect that holding company which is the lending company or guarantor or security provider as the case may be, does not included a foreign company. Section 185 of the Companies Act, 2013, *per se* is applicable to a company only (i.e. a company which is incorporated under the Companies Act, 2013 or any previous Companies Act).

24. Requirement - Loans to wholly owned subsidiary companies

Section 186(7) of the Act provides that no loan can be given at a rate of interest lower than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan to any company.

Suggestion

It is submitted that the Holding company should be exempted from charging any interest on loans extended to its wholly owned subsidiaries, further extending the exemption granted vide Rule 11 of the Companies (Meetings of Board and its Powers) Rules, 2014, where loans to wholly owned subsidiaries are excluded for the purpose of obtaining prior approval through special resolution.

While the Rules (Chapter 12) clarify that loans/investments/guarantees to wholly owned subsidiaries are not covered by Section 186(3) which is for prior approval by shareholders, there needs to be a specific clarification that the entire Section 186 shall not apply to such loans/investments/guarantees in such wholly owned subsidiaries. This is also in line with the current Section 372(A) of the Companies Act, 1956.

The Section 186 has been notified on 26th March, 2014 and the privileges available under section 372A are withdrawn e.g. applicability to private companies etc., which is matter of concern and needs reconsideration and transition time.

25. Requirement - Loans to other subsidiary companies

The rules permit a Company to grant loans or provide other assistance to a joint venture company or wholly owned subsidiary and states that the requirement of prior approval by special resolution under Section 186(3) shall not apply to such situations. However, this restriction continues to apply to loans given to a subsidiary company which is majority owned but is not wholly owned or a joint venture. Based on exemption granted to joint venture companies, MCA should considering extending the exemption to all subsidiaries.

Further, the MCA should clarify the position of loans given prior the commencement of the Act and whether any change in terms of such loans including extension of tenure will be considered as violation of Section 186 of the Companies Act 2013.

26. Conversion of Loan into Share Capital

Section 62(3) of the Companies Act and the Companies (Prospectus and Allotment of Securities) Rules, 2014 provide that loans raised by a company may be converted into share capital, if the terms of raising such loan contained an option to convert into share capital and that such term had been approved before the raising of loan by a special resolution. The Companies Act is silent on the aspect of conversion in cases where the option of conversion was not approved at the time of raising the loans.

Suggestion

Considering the provisions pertaining to conversion of External Commercial Borrowing (ECB) into share capital, which is permissible under the FEMA, it may be clarified that the shareholders may be permitted to ratify the option of conversion of the loan into share capital at a price to be determined by an independent valuer, by passing a special resolution.

Further, in terms of Form PAS.3 {Serial No. 4(iv)(e)}, 'conversion of loans into shares' is now being treated as an allotment for consideration other than cash. This is in deviation from judicial precedents and erstwhile DCA circulars, which clarified that conversion of a genuine debt (where a company had actually received cash) into shares, would be treated as allotment for cash. Pursuant to this, passing of a Special Resolution as referred earlier would need to be followed by a specific agreement between the company and the lenders (shareholders) setting forth the terms of conversion which would have to be filed with the Registrar of Companies as an attachment to the Return of Allotment. This may kindly be clarified.

REGISTERS; RECORDS; RETURNS

27. Requirement - Register of Members

- Rule 3 of the Companies (Management and Administration) Rules, 2014 requires companies to maintain information in the Register of Members (in Form No. MGT 1), including details such as Corporate Identification Number / Registration Number, Unique Identification Number, PAN Number, Nationality of shareholders, etc.
- Existing companies are required to compile the particulars of the register of members as per the new format from the date of incorporation. These companies are required to complete the whole exercise within 6 months time.

Suggestion

- In the prescribed Securities Transfer Form (Form No. SH.4) there is no provision to incorporate information in respect of Corporate Identification Number / Registration Number, Unique Identification Number, PAN Number, Nationality of shareholders, etc. It is submitted that Form No. SH.4 be appropriately modified to capture the information now mandated for incorporation in the Register of Members.
- The companies which are in existence for many years will find it difficult to compile the information within six months. Hence, MCA should consider doing away with this requirement at least for the companies which are in existence for a long time say more than 10 years. If not, the period may be increased to one year from the existing six months.
- The rules should clarify that in case of maintenance of register of members by a duly appointed RTA, this will be treated as sufficient compliance. In case of Listed Companies such register is maintained by RTA. In addition, since the entries are made in electronic mode by use of software's, the requirement of authentication of electronic registers prepared by RTA should be removed.

28. Requirement - Annual Return U/s 92, Chapter VII, Rule 11

Rule 11 of the Companies (Management and Administration) Rules, 2014 says that “Every company shall prepare its annual return in Form no.MGT-7”

Suggestions

These provisions should be applicable only for Annual Return to be filed in respect of AGM to be held for the FY commencing on date after 1st April 2014 because information required to be filed under MGT-7 is voluminous and may cause problems to comply with respect to AGM to be held in 2014 pertaining to FY ending 31st March 2014.

29. Requirement - Change in promoter stake

Section 93 – Change in promoters stake and Rule 13 of Companies (Management and Administration) Rules, 2014 prescribe that “Every listed company shall file with the Registrar a return in Form no.MGT-10 along with the fee with respect to changes relating to either increase or decrease of 2% or more in the shareholding position of promoters and top ten shareholders...either value or volume of the shares, within 15 days of such change...”

Suggestion

Given the disclosure requirements already existing under the SEBI Takeover Code and the SEBI Insider Trading Regulations, we would urge that this Section be deleted. Also requires clarification as to whether the existing position may be filed with ROC on coming into effect of the Act or not.

It is not clear how the return can be filed within 15 days of such change as in case of demat shares the beneficiary position is available only at the end of every week after which the company can possibly get to know the changes in the shareholding. Hence, it may be clarified that 15 days shall be counted from the date of beneficiary position download since it takes a couple of days for the RTA to process and forward the data to the company.

Further, the corresponding Rule 13 provides that the change either in value or volume of shares is to be reported. While the Section refers only to the number of shares held, the reference to value in the Rules is not relevant particularly as the Form No. MGT-10 also does not refer to value. In any case, if value refers to nominal value, the same does not generally change but if the reference is to market value, the same changes every minute during the trading hour for a listed company. Hence, it is not practicable to take the same into consideration. Therefore, the reference to value in Rule 13 may be deleted.

30. Requirement - Pre-certification of Forms, Returns, etc.

Under the new rules, e-forms will be directly scrutinized by the MCA officials instead of pre-certification by a Practicing Company Secretary or a Practicing Chartered Accountant, etc. as was done earlier.

Suggestion

Pre-certification enabled and ensured correctness of the documents by a practicing professionals before the same was filed with the MCA in terms of the requirements of the Act. Hence, this responsibility on

professionals for pre-certification of various e-forms should be restored to improve compliance and governance.

31. Requirement - Maintenance and inspection of documents in electronic form

Section 120 of the Act provides that companies **may** keep documents / records in the electronic form whereas Rule 27 of the Companies (Management and Administration) Rules, 2014 provides that every listed company or a company having not less than 1,000 shareholders, debenture holders and other security holders, **shall** maintain its records / registers etc. in electronic form. Section 120 provides that any document, record, register, minutes etc MAY be kept in electronic form. Rule 27 makes it mandatory for listed and companies having not less than 1000 shareholders to maintain its records in electronic form.

Suggestions

Section 120 of the Act captures the right intent that a company 'may' keep documents / records also in electronic form. This aspect should also be brought in Rule 27 where inadvertently the word 'shall' has been used. Considering the fact that Companies Act provides for flexibility but rules are making it mandatory so these should be aligned with Act by providing flexibility in Rules also. Further rules provide for conversion of physical data into electronic mode within 6 months w.e.f. 1st April, 2014 but we believe that conversion of previous data may be done away or atleast 1 year period should be provided.

32. Requirement - Fees for extract of documents / registers

Rules 14 & 16 (relating to inspection and copies of Register of Members and Annual Return), and Rule 26 (relating to copies of minutes of general meetings) of the Companies (Management and Administration) Rules, 2014 and Rule 12 (relating to extracts from Register of Loans and Investments) and Rule 16 (relating to extracts from Registers of Contracts or Arrangements in which Directors are interested) of the Companies (Meetings of Board and its Powers) Rules, 2014 provide that the fees for inspection / providing copies / providing extracts thereof to members etc. should be as specified in the Articles of Association of the company.

Suggestion

It needs to be clarified that it is not mandatory for a company to charge any fees for inspection / providing copies / extracts of records / registers to members etc. under the respective Rules where the Articles of Association of the company is silent with respect to charging of fees for this purpose.

33. Requirement of disclosure under Annual Return - Rule 11 (Section 92) :

In Form No. MGT. 7 at Serial No. IX point 2 (ii), the details of Director in other companies and changes are to be mentioned.

In Form No. MGT 7 at Serial No. XV, details of amount spent by the company under the CSR Policy are required to be mentioned.

Suggestion

As the Director's DIN will enable MCA to track his Directorship and stating again in the Form will be repetitive for all the companies in which the same person is director. Thus, the same may be deleted from Form MGT 7.

Details of CSR spend is already available in Board's Report under section 134, thus, the same may be deleted from Form MGT 7.

MEETINGS

34. Requirement - Board meetings through video conferencing

Section 173, 174 & 179 of the Act and Rule 4 of Chapter XII provides for convening and holding of board meetings through video conferencing (VC) or other audio visual (AV) means. However, approval of Financial Statements, Board's Report, approval of prospectus, audit committee meeting for consideration of accounts/approval of matter relating to amalgamation, merger, demerger, acquisition and takeover cannot be transacted through VC / AV.

Rule 3 of the Chapter further provides that though the Board meeting may take place through video conferencing or other audio-visual means, venue of the meeting should be in India.

Further, Rule 4(1)(iv) prohibits 'Audit Committee Meetings for consideration of accounts' through video conferencing or other audio visual means.

Suggestion

Instead of total prohibition for conducting the above matters through VC / AV, the Act & Rules may be amended such that subject to having a specified quorum through physical presence at the meeting, other directors should be permitted to participate in the proceedings of the meeting through VC / AV where the above items are transacted. Directors' presence through VC / AV need not be counted for quorum in such meetings. This relaxation would be immensely useful if the company has foreign directors. This will also be in line with the Green Initiative taken by MCA.

The MCA should also re-consider the requirement to enable board meetings to be conducted anywhere in the world through video conference or other audio-visual means.

The prohibition of 'Audit Committee Meetings for consideration of accounts' through video conferencing or other audio visual means should only be for consideration of "Annual Accounts" and not for quarterly accounts. In case the said restriction continues, practically no meeting of Audit Committee can be held through video conference. This is also in line with Rule 4(1)(i) of the subject Rules wherein it is mentioned that the "annual financial statement" cannot be considered in a meeting held through Video Conference.

35. Requirement - Voting through electronic mode

An annual general meeting needs to be convened by every company in terms of Section 96 read with Section 102 of the Act for transaction of the following businesses (Ordinary Business):

- consideration of financial statements and reports of board of directors and auditors,
- declaration of dividend,
- appointment of directors retiring by rotation, and
- appointment of auditors & fixation of their remuneration.

However, listed companies or companies having 1000 or more shareholders are required to provide for e-voting in respect of all businesses to be transacted at general meetings in terms of Section 108 of the Act read with Rule 20 of the Companies (Management and Administration) Rules, 2014. The Rule also provides that such e-voting shall end 3 days prior to the date of the general meeting.

Suggestion

In the context of the above, the following clarifications are sought:

- i) This should apply only to listed companies. To other companies it should be optional as many of members participating in the proceedings / voting through electronic means may also be deemed to have attended the meeting and counted for quorum as in the case of Board meetings.
- ii) Whether a listed company or a company having 1,000 or more shareholders is required to also place the items of Ordinary Business for approval at the annual general meeting through show of hands or poll. If not so, whether the purpose of convening an annual general meeting would be only for the Chairman to clarify the shareholders' queries, if any, and declaration of results of e-voting.
- iii) In the event some shareholders seek to vote on such items by show of hands or poll at the AGM, whether the Chairman of the meeting can advise that the results of e-voting are already available and no further voting is necessary.

This rule should clarify that all voting through electronic means should be held as conclusive evidence in any Court of law in India to give this further practical use. This would encourage companies for using voting through electronic means, and thereby, contribute in implementing green initiatives take by the MCA.

Due to such complexities involved and also this being a new concept, it would be a huge relief if corporates are allowed one year cooling period for this provision and accordingly this may be made applicable with effect from 1st April 2015. However, if the above is not acceptable then for at least this year, provision be made effective only for those shareholders whose e-mail addresses are already available with the company as AGM's are expected to take place for most companies in the month of June / July and it will be very difficult for them to procure such details in such a short time.

36. Records of meetings conducted by audio visual means - Rule 3 read with section 173

Suggestion

It should be required to record proceedings of audio/ video conference only of summary of decisions and assent or dissent and not the whole proceedings of Board meeting and such recordings may be required to be kept till Board meeting minutes are signed (such Board meetings may be running to say two or more days sometimes).

37. Requirement – Postal Ballot

In Rule No. 22(4), procedure to be followed for conducting business through postal ballot requires addition of the words ‘if any’ after the words ‘website of the company’

Suggestion

The exclusion of the recommended words appears to place an obligation on companies to maintain a website – which is not the intention of the rule / Act

38. Requirement – Filing and taking extracts of Board resolutions

By virtue of sec 179(3), there are several items that require a board resolution. This includes pure HR issues such as appointment or removal of (persons) one level below KMPs, and such purely noting issues such as disclosures of directors’ interest. This section, read with sec 117(3), ensures that each of these matters are filed with the Registrar of Companies. Taking together the items listed in sec 179(3) and those added by Rule 8 of Meetings of Board Rules, there are 18 items that require filing. Most of these are fairly frequent and may happen in every board meeting. In fact, sec 17 requires that any member of the company may ask for copies of these resolutions too.

Suggestion

This must be reconsidered since in essence, the board minutes lose their preserved classified status, and become public documents. This is a serious breach of confidentiality that board proceedings have so far enjoyed. This is in addition to the fact that the board, which is basically a policy-making tool, is getting into pure executive matters such as appointment of persons one level below KMPs.

In huge conglomerates, the structure of the organization is often spread wide, horizontally as well as vertically. Apart from the problem of identifying the employees forming a part of one level below the KMP, filing with the ROC, details of such appointment(s) or removal(s) will be inconvenient. Also such appointments or removals take place on a routine basis which would add to more burdens.

As per sub-rule (5) of Rule 8 mentioned above, every disclosure of director’s interest and shareholding will have to be reported. This will lead to tremendous pointless multiplicity. For instance, if a person is a director in 8 public companies, such company will have to report that particular director’s interest and shareholding in the remaining 7 companies. Such immense number of filing will not only lead to unnecessary burden of compliance on the companies but will also prove to be repetitive and costly for the companies.

It is suggested that the Ministry eliminate the requirement of filing the above with the ROC keeping in view the cumbersome activities that it may result into like manner of filing, payment of fees on filing and other hassles related thereto. In addition, private companies may be exempted from filing resolutions passed by Board of Directors.

DEPOSITS

39. Requirement – Transition

The new Deposit Rules have led to a situation where companies have i) Stopped renewing all deposits which were maturing from 1 April, 2014 and were coming up for renewal, and ii) stopped accepting all fresh deposits till they are compliant of all rules laid down. Thus retail investors are the sufferers since it will adversely impact especially retired persons / widows, who depend on interest income for running their homes.

Suggestion

Time-frame of at least 3 to 6 months should be given to companies to comply with the new rules.

40. Requirement - Applicability of Section 73 and 74 to eligible companies

One of the conditions laid down in Sub-section (2)(e) of Section 73 of the Act to qualify for accepting deposits from members is that the company has not defaulted in the repayment of deposits accepted either before or after the commencement of the Act or payment of interest on such deposits. It says:

“Pursuant to provisions of Sub-section (2) of Section 76 of the Act, the provisions of section 73 and 74 shall, *mutatis mutandis* apply to acceptance of deposits from public by eligible companies.”

It is felt that an otherwise eligible company u/s 76 should not be deprived from accepting deposits as provided under the Section just because there occurred delays in repayment of deposits or interest thereon at any time in the past since its inception. This provision is unjustified.

Suggestion

A specified time frame for such default must be prescribed. An exception may be provided in Rule 19 to the effect that Sub-section (2)(e) of Section 73 shall apply only in case of default in respect of deposits accepted as per this Act or the 1956 Act during a period of 5 years prior to the coming into effect of this Rule.

41. Requirement - Renewal of deposits matured but not claimed within a period of 7 years

Many companies renew deposits which are matured but not claimed within a period of 7 years from the date of last maturity, and the renewal happens with retrospective effect along with payment of interest for the relevant period at applicable rates.

Suggestion

It needs to be clarified whether companies can renew any deposit which has matured on or before 31st March, 2014. It is suggested that companies be allowed to renew the same, because since these deposits matured before 1st April, 2014, their renewal would be governed by the Cos (Acceptance) of Deposits Rules, 1975.

42. Requirement - Deposit Insurance

While Rule 5 talks about Deposit Insurance, the Indian insurance sector does not offer any insurance product for companies yet. Deposit Insurance & Credit Guarantee Corporation (DICGC) provides deposit insurance cover to banks only. Insurance Companies would need to structure product(s) for corporates and offer the same post approval from IRDA. This is a long drawn process consequent to which, though companies would have complied with all other requirements, they would not be able to renew existing deposits or accept fresh deposits because of non-compliance with the deposit insurance clause.

Suggestion

- Transition period of 3-6 months should be allowed. MCA should also impress upon Ministry of Finance to urge IRDA to implore Insurance companies to structure a product for deposit cover and give a fast track approval of the same.
- In the absence of availability of deposit insurance, all existing companies to which this rule applies and who have an existing public FD programme, should be allowed to renew existing deposits and accept fresh deposits provided all other new rules as laid down under the Companies (Acceptance of Deposits) Rules, 2014 have been complied with.
- This relaxation should continue till such time deposit insurance as a product is available to companies. Further, as and when the product is available, deposit insurance should be voluntary, because it only serves the investors stake to a limited extent of Rs 20,000 (i.e. small investors)., Companies who do not insure their deposits should be made to compulsory declare in all their forms, advertisements etc. relating to FD, that “Fixed deposit with the Company is not insured towards any default by the Company in repayment of principal and interest.”

43. Requirement - Deposit Insurance Cover

Rule 5 prescribes that (i) In case of deposit and interest not exceeding Rs 20,000/- the deposit insurance contract shall provide for full amount of interest and deposit, and (ii) In case of any deposit and interest thereon exceeding Rs 20,000 the deposit insurance contract shall provide for payment of an amount not less than Rs 20,000/- for each depositor. Thus according to the interpretation, say if all deposits accepted by a company are above Rs 20,000/- and if they have say 35,000 depositors, the deposit insurance cover should be Rs 20,000/- * 35,000 = Rs 70 Crore (even though the total deposit amount may be say Rs 500 Crore).

However, Explanation I of Rule 6-Creation of Security, states that total values of security by way of deposit insurance shall not be less than the amount of deposits accepted and interest payable thereon (in this case say Rs 500 Crore total deposits plus interest payable thereon) . This does not align with the leverage given in Rule 5 and thus companies would have to unnecessarily pay a premium for a higher sum insured, whereas the benefit to the depositor is limited to Rs 20,000/- only.

Suggestion

This needs to be aligned and clarified.

44. Requirement - Other clarifications on deposits

Section 74 - repayment of deposits - states that the deposits accepted before commencement of the new Act have to be repaid within one year from the commencement of the new Act. However, in Chapter V - Rule 19 provides that earlier deposits accepted under the 1956 Act can be repaid on the due dates for the remaining period of such deposits.

Suggestion

Clarification is required wrt:

- (1) Whether repayment of deposits on the due dates for the remaining period of deposits accepted earlier would be sufficient compliance under section 74 of the new Act without approaching CLB / NCLT for such dispensation.
- (2) In the event the company decides not to accept any new deposits w.e.f. April 1, 2014, whether compliance to section 73(2) & 76 would still be required until full repayment of such deposits on maturity as per the respective due dates.
- (3) The extent of liquid deposit (of 15% of deposits maturing during the FY and the next FY to be kept in a deposit repayment reserve account in a scheduled bank) – whether to be created on the entire amount of deposits.

RELATED PARTY TRANSACTIONS

45. Requirement - Section 188 read with Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014

Sub-rule (3) of Rule 15 has prescribed the limits for contracts or arrangements entered into by a company with a related party which would require prior approval of the shareholders. The first proviso to sub-section (1) of section 188 when read with the corresponding rule, infers that, no contract or arrangement, in case of a company having a paid up share capital of ten crore rupees or more, or transactions exceeding the limits prescribed in the rule, shall be entered into except with the prior approval of the company by a special resolution. Also, the limits prescribed under the rule are bifurcated into a company having a paid up share capital of Rs. 10 crore or more or a company exceeding the individual transaction(s) limits mentioned thereunder. Due to this it can be inferred that for companies having a paid up share capital of Rs. 10 crore or more, shareholder's approval will be required irrespective of the value of transaction(s) whether breaching the limit or not. Provision of limits as stated in the rules, falls out of the ambit of the provisions of this section of the Act as the second proviso to sub-section (1) of section 188 exempts any related party transaction(s) sufficing the two conditions of being in ordinary course of business and at arm's length from obtaining the shareholder's approval.

Suggestion

Ministry must explain the significance of the limits given in the rules and the criteria to be considered to classify the category of the related party transaction requiring/not requiring Board/Shareholder's approvals.

Also, it will assist corporate India if some guidelines are provided as to which transactions would be and would not be in the ordinary course of business or on arm's length basis, particularly since the consequences of default are severe.

Section – 188 (second proviso to sub-section 1) and Second explanation to Rule – 15(3) of the Companies (Meeting of Board and its Powers) Rules, 2014 provide that no member of the company shall vote on such special resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party. It says that in case of wholly owned subsidiary, the special resolution passed by the holding company shall be sufficient for the purpose of entering into the transactions between wholly owned subsidiary and holding company.

Suggestions

The paid up capital threshold as provided in this rule, may be considered to be further increased to say INR 100 Crores

Relaxation, as given in 2nd explanation of Rule 15(3) in case of wholly owned subsidiaries, should also be provided to private companies and closely held companies for the provisions relating to 2nd proviso of sub-section 1 of section 188.

The concept of Interested Shareholders (third proviso to Section 188(1)) will need to be clarified in case minimum quorum is not met without the presence of such interested shareholders. This needs to be clarified otherwise there will be a deadlock at shareholder meetings for such related party transactions in which shareholders are interested.

For Board Meetings, it is recommended that a concerned director may be allowed to remain present at the time when item for entering into contract or arrangement is going to be considered by the Board at the meeting but not allowed to participate in such discussions or vote on the resolution. An interested director may also not be counted towards constitution of quorum.

This prescribed requirement of passing a special resolution at holding company level (in respect of transactions between holding company and its wholly owned subsidiary), may be replaced with the Board resolution.

It may be clarified that director or key managerial personnel of the holding company or his relative as the case may be, is restricted to a holding company which itself is an Indian company i.e. director or key managerial personnel of a holding company (being a foreign body corporate) would not be considered as a related party. Section 2(76) of the Companies Act, 2013, *inter-alia*, includes a company (i.e. a company which is incorporated under the Companies Act, 2013 or any previous Companies Act) which company *inter-alia*, is a holding, subsidiary etc. of a company.

Rule 8(2) (Details of material contracts with related party) provides that the Report of Board shall contain the particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in Form AOC-2. Item 2 of Form AOC-2 requires details of material contracts or arrangements or transactions at arm's length basis.

Suggestion

Section 188(1) does not cover contracts or transactions at arm's length basis in the ordinary course of business. Therefore item 2 of Form AOC-2 is beyond the scope of the Act and may be deleted.

A pragmatic view needs to be taken for related parties transactions in general so that the requirements are not duplicated under the Companies Act and Listing Agreement and the procedure is simple and easy to implement by Companies without imposing compliance requirements which do not serve any purpose. A holistic review of this is requested keeping in view the practical business aspects into consideration.

SHARE CAPITAL AND DEBENTURES

46. Requirement - Companies (Share Capital and Debentures) Rules, 2014

Section 47 of the Companies Act 2013 provides for Voting rights of Preference Shareholders. Earlier, explanation to Section 87 of the Companies Act, 1956 clarified when dividend shall be deemed to be due on preference shares, which has now been omitted in the Companies Act, 2013

Suggestion

Such Explanation should be given in the Rules. Explanation is necessary for bringing better clarity in the provision. This is provided in Companies Act, 1956.

Also, it may be clarified whether optionally convertible preference shares will form part of the “Total Share Capital” for the purposes of Section 2(6) and Section 2(87) of the Act or not. Ideally the definition should include Compulsory Convertible Preference Shares and not the Convertible Preference Shares since, the CCPs have definite inclination and impact on Equity share capital than optionally Convertible Preference Shares

47. Requirement - Prospectus and allotment of securities

Section 25 states that an allotment or an agreement to allot securities made with a view to the securities being offered for sale to the public (within 6 months after date of allotment) shall be considered as a public offer and the company shall prepare and file prospectus with SEBI and ROC in accordance with the provisions of the Act.

Suggestion

It may be clarified whether down selling of securities, if any, by the allottees within 6 months from the date of allotment will be treated as public offer. It is a very important to get clarity from the perspective of corporate lending and debt securities placement.

48. Requirement – Stock Exchange permission

Section 40(1) of the Act requires a company to make an application to the stock exchanges for listing of securities and obtaining the permission, prior to making an offer. The requirement under Section 73(1) of the Companies Act, 1956 was only to make an application.

Suggestion

It may be clarified whether permission in this provision refers to in-principle approval from the stock exchanges or the final approval. In discussions with stock exchanges, it has been indicated that they are unlikely to give final approval prior to allotment of shares. There may be practical difficulties in complying with this requirement.

49. Requirement - Private Placement

Rule 14 of the Companies (Prospectus and Allotment of Securities) Rules, 2014 provides that a company shall not make a private placement of its securities unless –

(a) the proposed offer of securities or invitation to subscribe securities has been **previously** approved by the shareholders of the company, by a Special Resolution, for each of the Offers or Invitations.

Provided that.....

Provided further that in case of offer or invitation for non-convertible debentures, it shall be sufficient if the company passes a previous special resolution only once in a year for all the offers or invitation for such debentures during the year

By nature of its business, non-banking financial companies (NBFCs) are required to raise funds by way of issue of, inter alia, non-convertible debentures, commercial papers etc. on private placement basis. NBFCs will lose the opportunity of raising the funds at attractive interest rates for 2-3 months if the requirement of obtaining shareholders' prior approval is forced immediately as the process of obtaining shareholders' approval will take 2-3 months' time

Suggestion

It is submitted that when the Section 179 of the Act empowers the Board, inter alia, to issue securities including debentures whether in or outside India. The Section does not put any fetters on the Board for exercising this power. It does not contemplate sanction of shareholders for an issue of debentures, the rules cannot go beyond the scope of the Act. This may be clarified.

In addition, a clarificatory amendment be made exempting listed companies from the requirement of rule 14, in view of Section 24 of the Companies Act, 2013. Listed companies which are required to comply with regulations made by SEBI in this behalf and similar exemption also exists in the Companies Act, 1956. Non-banking financial companies should also be exempted from the applicability of the said rule as was proposed under draft rules. Alternatively, in case of non-banking financial companies, the requirement of **prior** special resolution of shareholders be removed.

Also existing filing of shelf disclosure document / addendum under the same/ stand alone disclosure document has all the information requirement now sought to be provided to ROC and SEBI in different format is multiplicity of formats. This should be avoided. Investors have all details like listing of securities/ view of SDD from NSE and need not go to ROC web site for viewing the same. The utility of filing with ROC is also not clear. So it only amounts to additional work for the issuer and no corresponding benefit for investors.

There is also provision for serial numbering of offer letter/ offer letter format in PAS 4, submission in 30 days. The requirement would add to high volume of paper work. As the company is listed and has put many of its financials related data on web site, at offer stage, sharing details as listed in PAS 4 would be uncalled for and premature. In case of unlisted company also sharing such data may not be contemplated in SEBI DIP guidelines. Presently only the commercial terms of a deal are shared in offer letter. This may be left as it is. Private placement investors are well informed corporate. Listed companies mainly are provided with such options. Existing market practice of offer letter being restricted to terms of the deal may be left untouched.

50. Requirement – Interplay of private placement and further issue of capital

Pursuant to the Rules issued with regard to Section 62 (*Further Issue of Share Capital*), any offer made pursuant to Section 62(c) on a preferential basis to any person other than an existing shareholder is also required to comply with the conditions laid down in Section 42 (*Private Placement*). This effectively means that any preferential issue, even if to a single investor, is required to comply with the provisions applicable to a private placement. Pursuant to the Rules issued with regard to Section 42, every offer to subscribe to securities must be made through the issue of a private placement “offer letter” in prescribed Form PAS-4. In light of (a) and (c) above, this effectively means that every preferential allotment under Section 62(c) will need to be accompanied by the prescribed “offer letter”. The prescribed format of the offer letter is extremely detailed, requiring information such as (by way of example and not an exhaustive list):

- (i) Details of any litigation against the promoter of the relevant offeree company during the past three years;
- (ii) Details of all related party contracts entered into during the past three years;
- (iii) Details of any inquiry, inspections, investigations initiated under the Companies Act, 1956 or any previous Company law against the relevant offeree company or any of its subsidiaries during the last three years.

This substantially increases the disclosures and procedures required to be followed in the event of a preferential allotment by way of a private placement. In most cases preferential allotments are by their very nature made to sophisticated and well informed investors, who would have conducted a due diligence and satisfied themselves prior to an investment.

Suggestion

Given the impact that the increased requirements will have from the perspective of timing and ease of capital raising it is urged that the requirement of an offer letter be done away with entirely as the same should not be applicable in the case of private companies, and listed companies are already subject to disclosure requirements prescribed by SEBI in this regard. This leaves the category of unlisted public companies. If felt necessary, the requirement of an offer letter may be made applicable to specified unlisted public companies based on certain thresholds of paid up capital etc. (as is the case with several other Sections).

Under Section 42(7), a requirement has been included that in case of private placement, offer shall be made only to such persons whose names are recorded by the company prior to invitation to subscribe, and such persons should receive the offer in their name. It may be practically very difficult to undertake Qualified Institutional Placements under the SEBI ICDR Regulations, due to this requirement – hence must be removed.

Also, it is provided that private placement offer can be made to persons not exceeding 200 in a financial year. It may be clarified if the same person is offered the securities each time the offer is made through private placement in a financial year, for the purpose of reckoning the total count of 200 persons, whether such person will be considered as one offeree or as many times as he would have been offered the securities.

Also, there needs to be clarity on whether fair valuation is required in case of all preferential offers.

It is also suggested that the limit given under sub-section (5) of section 71 be extended in case of appointment of debenture trustee while offering secured debentures as well.

51. Requirement – Issue of preference shares

There seems no reasonable ground for enhancing the requirement of obtaining shareholders' consent through a 'special resolution' (in relation to issuance of preference shares) from that of an 'ordinary resolution'

Suggestion

It is recommended that the requirement of 'special resolution' be replaced with that of an 'ordinary resolution', in view of the reason that that this may cause unnecessary hardship on corporates in carrying out the smooth functioning of its affairs. The provisions of erstwhile section 80 read with Regulation 2 of Table A of Schedule I of the Companies Act, 1956, which were governing the issuance of preference shares in past, may be considered as base for brining the requirement of 'ordinary resolution' back in place of that of 'special resolution' as provide in this Rule.

In addition, it may be noted that there are a number of companies that have obtained approvals from shareholders in terms of the Companies Act, 1956. Such approvals should continue to be valid and effective for raising preference shares under the 2013 Act for a period of at least 6 months from the commencement date of the relevant section of Companies Act, 2013.

There has been a precedent in this regard wherein a clarification was issued by MCA vide General Circular no. 4/2014 dated 25/03/2014 with reference to another section on borrowings and/or creation of security, based on the basis of ordinary resolution. The matter was examined in the Ministry and clarified that the resolution passed under section 293 of the Companies Act, 1956 prior to 12.09.2013 with reference to borrowings (subject to the limits prescribed) and / or creation of security on assets of the company will be regarded as sufficient compliance of the requirements of section 180 of the Companies Act, 2013 for a period of one year from the date of notification of section 180 of the Act. It is thereby represented that the said rule too should be clarified on similar lines.

52. Requirement – Issue of employee stock options

The Rule prescribes that approval of shareholders by way of separate resolution shall be obtained by the company in case of grant of option to employees of subsidiary or holding company.

Suggestion

The word 'associate company' should also be added to the list of subsidiary and holding as referred to in this rule. In view of the expanded base of eligible employees under the explanation appended to rule 12(1), which now includes employees of associate companies also. Inclusion of associate company under this rule is thus rational.

53. Requirement – Shares with Differential Rights

- The Rules lay out requirements pertaining to the issuance of equity shares with differential rights.

- In order to issue shares with differential rights, the company should not have incurred a penalty for any offence under RBI Act, SEBI Act, SCRA, FEMA or any special Act under which the company is being regulated during the last three years.

Suggestion

At the outset, we recommend that private companies be given exemption from complying with the requirements under this rule pertaining to the issuance of equity shares with differential rights. The exemption under provisions of erstwhile section 90 of the Companies Act, 1956, may be considered as justifiable ground for granting necessary exemption to private companies from complying with the requirements pertaining to issuance of equity shares with differential rights. In relation to granting necessary exemption to the private/public companies in relation to their existing equity shares with differential rights, it is submitted that it would be unfair if this rule is made effective retrospectively, so as to bring in its ambit the existing equity shares with differential rights, issued by the private/public companies under the provision of the Companies Act, 1956.

Additionally, necessary clarifications need to be provided in relation to the following:

- (1) saving provisions in respect of the existing equity shares with differential rights, which have already issued by private companies under the explicit exemption granted to such companies under the provisions of section 90 of the Companies Act, 1956, else this rule would have the effect to make the proposed requirements being effective retrospectively, which does not seem to be the intention;
- (2) saving provisions in respect of the existing equity shares with differential rights, which have already been issued by public companies in accordance with the provisions of section 86(a)(ii) of the Companies Act, 1956 read with the Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001; and
- (3) Necessary clarification be provided in relation to Explanation appended to Rule 4 which is leading to a vague interpretation. The said explanation is reproduced as under:

“For the purpose of this rule, it is hereby clarified that differential rights attached to such shares issued by any company under the provisions of Companies Act, 1956, shall continue till such rights are converted with the differential rights in accordance with the provisions of the Companies Act, 2013.”

It is recommended that the concept of materiality/threshold for penalties be introduced and if the penalties are beyond certain threshold than in that event only the restriction may be imposed so that the minor / technical violations do not prevent the company to undertake normal activity.

54. Requirement – issuance of sweat equity shares

There is a restriction on issuance of sweat equity shares in a year up to prescribed thresholds. However, there seems no reasonable ground for capping the total sweat equity shares in a company at 25% of the total paid up equity capital of the company.

Suggestion

The aforesaid restriction/capping may accordingly be removed. Else, it may be considered to provide that issuance of sweat equity shares beyond the aforesaid thresholds of 25%, may be done with the prior government approval. The provisions of Rule no. 6 of erstwhile Unlisted Companies (Issue of

Sweat Equity Shares) Rules, 2003, which were governing the issuance of sweat equity shares in past, may be considered as base for this, which provides that a company shall not issue sweat equity shares for more than 15% of total paid up equity share capital in a year or sweat equity shares of the value of Rs.5 crores, whichever is higher except with the prior approval of the central government.

55. Requirement - Pricing

Private companies should be exempt from having to comply with Section 62 (as was the case with Section 81 of the Companies Act, 1956. Further, when any issuance is undertaken to a person other than existing shareholders, given that there is a requirement to obtain shareholders approval (by way of a special resolution), it is not clear why the price then has to be as arrived at by a Registered Valuer. If minority shareholders are of the view that a price is unfair, the remedy of oppression/mismanagement, as was available under the Companies Act, 1956 – continues to be available under the 2013 Act. Valuation is a matter of internal management of a company, there are various factor that could affect the same, such as availability of funds in the market, the rights that an investor may seek in the company etc.

To have mandated pricing regime restricts the basic right of a company to be able to raise funds. Further, with regard to foreign direct investment in particular, the Reserve Bank of India today already provides specific pricing guidelines that need to be followed in the case of an issuance of shares to a non-resident. It is confusing how the RBI pricing guidelines work along with this new pricing regime. For instance, the RBI regulations permit a pricing formula with regard to preference shares being issued to a non-resident, however, the 2013 Act requires a specific price to be decided upfront. Further FVCIs are not subject to any pricing restrictions – this is now being made applicable to FVCI investments as well. Further the Rules provide that even instruments such as warrants will be subject to the relevant valuation. It is challenging to fix the price of a future issuance today. This is neither in the interests of the shareholders or the company.

Suggestion

It is urged that this requirement be deleted. Pricing should be left to the market and not be legislated. If at all a valuation is preferred, the same must not be binding on the Company. It could be suggested to be included in the Explanatory Statement sent to the shareholders – so that the shareholders are assisted in taking an informed view, however the same should not bind the company to issue shares only at the price arrived at by a Registered Valuer.

56. Requirement - Issue of Secured Debentures

The rules with regard to the issue of secured debentures provide that such debentures must be secured against “specific” movable property (not being in the nature of a pledge) or “specific” immovable property of the issuing company. A charge on specific movable or immovable property means a fixed charge – which would mean that current assets would not qualify for the purposes of securing debentures. In case of several bond issuers such as NBFCs, there are no assets other than current assets to secure secured debentures. The primary issuers of bonds are banks and NBFCs – and this Section and the Rules apply to all companies and provide no exemptions to such entities. Given that unsecured bonds would get hit by the deposit rules, bonds need to be secured to be viable for issuance.

Suggestion

- In light of the issues discussed above, we would urge that this new requirement to secure bonds against specific property be deleted. This would otherwise result in a significant adverse impact on the bond market, which has been very active in the past few years.
- Also, there should not be any restriction on maximum tenure for debentures for any class of companies i.e. whether for companies (*other than companies engaged in infrastructure projects*) or companies into infrastructure projects, which tenure should be left upon the mutual understanding of the borrower companies and the lenders. As compared to no time limit for issuance of debentures under the Companies Act, 1956 (which debentures might even be issued for perpetuity under the Companies Act, 1956), the present restriction imposed under this rule on maximum tenure of debentures, seems to block long term funding structures of corporates.
- Talking about movable property, Companies issue secured debentures through creation of a charge on movables, which, inter alia, includes receivables, inventory, finished goods and the like. Movable property, by its very nature could be identified as a class (like Receivables) but the items constituting that class cannot have a specific identification. For example, Receivables keep getting repaid and are substituted by other Receivables, maintaining the overall value of the security. However, the word “**specific**” occurring before “**movable property**” in Rule 18 (1)(d)(i) may lead to an interpretation that each movable asset needs to be identified, which is not practical to implement due to the following reasons :
 - The list would be humongous for each charge on movable property
 - The list would keep changing; older assets would be replaced by new assets on a daily basis

It may be relevant to furnish an example. A Company would create a charge on movables in the nature of Receivables from funding of farm equipment. The charge would cover receivables of Rs. 50 crore, which would consist of about 1700 loan accounts. These accounts would get repaid on a daily basis and get substituted by fresh loans. Thus, the charge would be on specific movable property (Receivables from farm equipment funding) but not on specific accounts within the pool of Receivables, which would keep changing due to repayment.

It is therefore requested to issue a clarification that the word “specific” occurring before “movable property” in Rule 18(1)(d)(i) is meant to denote that while the class of movables needs to be specific, it is not intended that each movable property within the class needs to be specifically identified OR the word ‘specific’ be dropped as, in any case, the nature of movable property needs to be identified.

57. Requirement - Debenture Redemption Reserve

Rule 18(7) u/s 71 provides for requirement to create debenture redemption reserve. As per MCA circular no. 9/2002 dated 18 April 2002 and 4/2013 dated 11 February 2013, non-banking finance companies are exempted from the requirement of creation of Debenture Redemption Reserve in case of privately placed debentures under the Companies Act, 1956. The Final rules do not contain the aforesaid exemption. Systemic Important Non Banking Finance Companies (SI NBFC) observe prudential norms, capital adequacy ratio, create Special Reserve for fixed deposits. Similarly Core Investment Companies –NBFC also have to maintain tight leverage and capital ratio as per RBI norms. Under the current provisions DRR for debentures would seriously affect the ability of NBFCs to have

adequate allocable surplus for declaring dividends since a major part of the profits would be deployed in financing the reserves. The ability to service the equity holders would have an adverse impact on further raising of the “risk capital” by NBFCs

This will amount to lot of hardship and financial stress since, in case of non-banking finance companies, amount mobilized through privately placed debentures constitute major chunk of funds raised in the ordinary course of business. Further, in case of listed companies, such privately placed debentures are also listed on stock exchanges pursuant to SEBI (Issue and Listing of Debt Securities) Regulations, 2008 which do not require creation of Debenture Redemption Reserve.

Suggestion

Non-banking finance companies be exempted from the requirement of creation of Debenture Redemption Reserve in case of privately placed debentures. Further, the requirement of investing 15% of the amount of debentures maturing during the year be also not made applicable to NBFCs considering the nature of their business.

It is also requested that instructions contained in Circular 4/2013 dated 11.02.2013 issued by MCA on adequacy of DRR be reinstated for development of corporate bonds/debentures:

- DRR was introduced to protect the interests of small investors, meaning investors through public issue, as investors through private placements are normally institutions or High Networth Individuals.
- Financial Institutions / NBFCs / HFCs were permitted to not create DRR on private placements, considering that they were already regulatorily required to transfer 20% of their profits to reserves.
- On public issues, the DRR was required to be created to the extent of 50% of the amount of debentures raised through public issue, reduced to 25% by virtue of Circular 4/2013. Now, Rule 18 has done away with the distinction between private and public placement and between NBFCs / HFCs and other institutions on the quantum of DRR. Thus both private placements and public issues require creation of DRR and all entities, whether NBFCs / HFCs or otherwise are required to maintain DRR at 50%. This affects NBFCs who nature of business is to leverage at 6- 8 times.
- Only 25% DRR was to be created and that too only for publicly raised debentures.

58. Requirement – Appointment of debenture trustee

Sub-section (3) of section 71 read with clause (c) sub-rule (1) of Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014 states that the company shall appoint a debenture trustee before the issue of prospectus or letter of offer for subscription of its secured debentures. Unlike, sub-section (5) of the abovementioned section 71, there is no limit given as to when the appointment of a debenture trustee would be mandatory. Hence, this would result in appointment of a debenture trustee in case of offer or invitation to subscribe for secured debentures irrespective of the limit exceeding five hundred or not.

Suggestion

It is suggested that the limit given under sub-section (5) of section 71 be extended in case of appointment of debenture trustee while offering secured debentures as well.

59. Requirement – Registration of charges

While the Companies Act, 1956 prescribed the classes of property and assets which when charged required to be registered. The Companies Act, 2013 mandates registration for any and all charges, created within or outside India, on property, assets or any of the undertakings of a company, whether tangible or otherwise, and situated in or outside India. While the draft rules had listed out specific property to which this was applicable (much like the Companies Act, 1956), the final Rules published have removed this provision.

Suggestion

- Further reconsideration is requested in this regard. The draft rules were trying to give sanctity to this by providing for registration of only certain category of charges. However that category of charges has been dropped in the final Rules and will require every charge (including pledge) to be registered. This is unfair, for example, there is absolutely no sanctity in registration of a pledge as a pledge is a possessory security interest and the asset is already with the lender. A pledge on movables neither creates an interest or a lien but rather is a special property.
- Though Rule 3(3) of Rules prescribe when a charge holders will become eligible to file for a charge, *i.e.* in case of failure by the company to register the charge within 30 days of its creation or modification, it does not prescribe the outer time limit within which such application may be made.
- Per the Rules companies would have to file Form CHG 1 for registration of charge on Hypothecation of Motor Vehicles. This was exempt under draft Rules. The said exemption may continue to be offered
- Clarification is needed that condonations may be obtained by the Company and the Charge holders (interest persons).

60. Issue of Shares at a discount

Section 53 prohibits a Company from issuing shares at discount except for stock options. This is contradictory to the provisions of SEBI ICDR regulations which requires a Company to issues shares based on market price which could be less than the face value for certain kinds of companies like loss making or early stage companies.

Suggestion

An absolute prohibition of issuing shares at discount could potentially affect a Company from raising capital during difficult times. We recommend that the MCA modify this requirement and permit issue at discount provided it is backed up by a valuation by a Registered Valuer.

ACCOUNTS

61. Requirement - financial year

The definition of term “financial year” is applicable from 1 April 2014. It requires a company to adopt a uniform accounting year ending 31 March. Companies which are currently following a different financial year need to align with the new requirement within two years.

A proviso to the definition states that a company may apply to the National Company Law Tribunal (NCLT) for adoption of different financial year, if it satisfies the prescribed criteria.

However, the Central Government has still not constituted the NCLT and many provisions relating thereto are not currently notified. Thus it is currently not clear, which authority companies seeking extension / exemption should apply to.

Suggestion

Under the section 434 of the 2013 Act, certain matters pending with the High Court, District Courts or the Company Law Board (CLB), as the case may be, which will be within the jurisdiction of the NCLT, would be transferred to the NCLT from a notified date. Till such time, the courts and the CLB will continue to function. In the absence of a NCLT, the MCA should specify any of these authorities to which an application is to be made for extension / adoption of a financial year other than one ending on 31 March.

62. Requirement - Financial statement of the subsidiary

Section 136(1) requires that audited financial statement of the subsidiary should be placed on the website of the company. This will provide access to non-public information of foreign subsidiaries to the competitors

Suggestion

MCA should dispense with this requirement. Section 129(3) in any case requires that a separate statement containing salient features of the financial statement of its subsidiaries in the prescribed form to be attached to the company's financial statements. Companies should not additionally be compelled to put information on the website which are not in the interest of the company.

Also pursuant to MCA's General Circular No. 2/2011 dated February 8, 2011, companies were exempted from annexing the accounts of subsidiary companies provided under Section 212 of Companies Act, 1956, subject to the approval of Board of Directors and compliance with certain other conditions. There is no such exemption provided under the Act. It may be clarified whether exemption under the MCA's General Circular No. 2/2011 dated February 8, 2011 is applicable to provisions under the Act – since it may be practically difficult to provide the accounts of all subsidiaries to the shareholders and at the AGM, as required under Section 129(3) of the Act.

63. Financial Statements of foreign subsidiaries

If at all it is decided to require that the audited financial statements of the subsidiary be placed on the company's website, it is currently not clear whether financial statements of foreign subsidiaries for such purpose, needs to be prepared in accordance with Indian GAAP, i.e., notified accounting standards and Schedule III, or will it be sufficient compliance if a company uses the financial statements prepared as per local GAAP for this purpose.

Suggestion

It must be clarified that that it is acceptable to host foreign subsidiaries' local GAAP financial statements on the website. because of the following reasons:

(a) With the Globalisation of the Indian economy, Indian Companies are not only competing within India but also with the competition operating world over. It is imperative that the extent and nature of disclosures required in different geographies are similar, so as to facilitate the comparison of financial statements and other reports like Directors' Report, across the Globe. With this objective, most of the countries world over, either, permit or requires the use of International Financial Reporting Standards in the preparation of financial statements. Regulations vary from one geography to the other and the additional disclosures required under the local regulations in a geography must not jeopardize the position of entities operating in that geography, which might put these entities on a weak footing against the competition as similar disclosures might not be required in the jurisdiction of the competition. Disclosure of salient features of the financial statement of a company's subsidiaries, associate companies and joint ventures is also prescribed. Further, the fourth proviso to section 136(1) requires the uploading of financial statements of subsidiaries on the company's website. These provisions put Indian companies on a weak footing vis-à-vis the competition, as such details are not required to be published by their foreign counterparts under the regulations applicable to them.

Further, the private Indian companies whose parent is a foreign entity does not publish its financial statements for public use, however, financial statements of similar companies with Indian parent would be required to be published, which will jeopardise the position of such Indian companies. Further, though the regulation is silent on the time lines until when the financial statements of the subsidiaries are required to be uploaded on the website, such a requirement poses challenges for companies operating globally, as some jurisdictions does not require the preparation of financial statements or allow time for filing of financial statements which is considerably more as compared to the time allowed in India. Though for the purpose of facilitating the preparation of consolidated financial statements of Indian Parent, the Group reporting packs of all the subsidiaries/joint ventures/associates are audited, except in case of certain immaterial entities, the financial statements are not audited by the time Indian parent is required to publish its consolidated financial results/statements. Application of different accounting standards and different accounting periods required to be followed in different geographies further adds to the problem.

Publishing information in IFRS / local GAAP is further supported since Section 129 which deals with preparation of financial statements as per notified accounting standards (Indian GAAP) and Schedule III, is not applicable to foreign companies. Also, Section 2(40) of the 2013 Act defines the term "financial statements." It prescribes the minimum components of financial statements; however, it does not require whether these financial statements should be prepared as per Indian GAAP or any other GAAP.

64. Preparation of CFS under IFRS/Indian GAAP

Currently, the listing agreement permits companies to prepare and submit consolidated financial results/ financial statements in compliance with IFRS as issued by the IASB. For a company taking this option, there is no requirement to prepare CFS under Indian GAAP.

Suggestion

Listed companies should continue to have an option to prepare either Indian GAAP or IFRS CFS, as per the listing agreement(also explained in detail above). This will also exempt non-listed intermediate holding companies from preparing CFS.

We recommend that MCA should allow companies to voluntarily prepare CFS under IASB IFRS instead of Indian GAAP. More than 100 countries around the world use IFRS, which is now effectively a gold standard. Therefore, it would be inappropriate, to not accept IFRS CFS. We also recommend that when Ind-AS are notified for preparing CFS, they should be notified with no or very few changes from the IASB IFRS.

65. Requirement - Mandating to certify Internal Financial Controls instead of Internal Control over Financial reporting (ICOFR)

The explanation to section 134(5)(e) defines 'internal financial controls' which is a wide term and encompasses any control which helps in "ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.". Further, section 143(3)(i) provides that auditor's report should state whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls.

Suggestion

As seen from the above, the ambit of controls included in this phrase include all controls established across the company (including tracking in and out time of employees / use of supplies, etc) and is not restricted control on financial reporting. Financial reporting refers to the financial reports generated and published / submitted by the company which are prepared in compliance with a statute. Internal controls over financial reporting refer to specifically only those controls which directly have an impact on the financial reporting done by the company. Consequently they cannot be equated. The international practice is to require the directors and thereafter the auditors of the company to comment only on internal control over financial reporting. This international practice is reasonable, considering that the directors are not involved in overseeing the "adequacy and operating effectiveness" of all the internal controls. Similarly, auditors are also not required to evaluate the "adequacy and operating effectiveness", as it would not be relevant to financial reporting, which is their sole ambit of audit. Consequently, it is suggested that the Act should focus only on internal controls over financial reporting in line with the international practices.

Rule 8(5)(viii) of Chapter 9 attempts to address this and clarifies that companies need to present details in respect of adequacy of internal financial controls with reference to the Financial Statements. As explained above, MCA must amend this clause to say "Internal Control over Financial Reporting" so that it is in line with the Cl49 of the Listing Agreement as well as International regulations. Going into Internal Financial Control makes it too onerous & possibly impossible to actually achieve for many companies since it is broader & subjective.

AUDIT AND AUDITORS

66. Rotation of auditors

The following class of companies cannot appoint or re-appoint an audit firm as auditor for more than two terms of five consecutive years:

- (a) all listed companies;

- (b) all unlisted public companies having paid up share capital of rupees ten crore or more;
- (c) all private limited companies having paid up share capital of rupees twenty crore or more;
- (d) all companies having paid up share capital of below threshold limit mentioned in (b) and (c) above, but having public borrowings from financial institutions, banks or public deposits of rupees fifty crores or more.

The auditor who has completed the aforesaid term, will not be eligible for re-appointment as auditor in the same company for five years from completion of the term.

This restriction will apply to the audit firm which has common partner(s) with the outgoing audit firm at the time of appointment or is under the same network of audit firms.

If a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.

For the purpose of rotation, the period for which a firm held office as auditor prior to the commencement of the Act shall be taken into account for calculating the period of five consecutive years or ten consecutive years, as the case may be.

Suggestions

The mandatory firm rotation rules are likely to cause major disruption for both, companies and audit profession due to its application to private limited companies in particular relating to subsidiaries of Foreign companies who have obviously not taken any equity or borrowings or deposits from general public or financial institutions

Globally in countries where auditor rotation is mandated, e.g. in Italy and Netherlands, it is applicable only to listed entities or public interest entities like banking and insurance companies, while in Brazil, it is applicable only to listed companies. In none of these geographies, rotation is applicable to private companies or even to unlisted public companies.

Many global companies have subsidiaries in India. Typically, they prefer having firms, which are part of common network, as their global auditors. This would create some challenging situations for Indian subsidiaries of multinational companies.

The threshold for auditor rotation in India has been kept extremely low, as a result of which, even small unlisted public companies as well as private companies with no public exposure will also have to search for new auditors immediately. This will pose immense practical difficulties for these companies.

Accordingly, we recommend as below:

1. CII strongly recommends re-consideration of the retrospective application of this rule. In any event, consideration needs to be given to cases where the auditor had a break of in between, for instance, an auditor engaged for last 3 years had a break for an year prior to commencement of the Act. It is recommended that the rules clarify the applicability of such break provisions; and that this period be disregarded from the calculations of 5/10 years at the time of commencement of Act.

2. Audit Rotation should be restricted to listed entities and public interest entities (banks, insurance companies, public financial institutions) which would be consistent with international practices.
3. Rotation should not be mandated for private companies (particularly private companies which are subsidiaries of foreign companies) as it not likely to have significant impact on auditor independence. Also, it may be noted that as per the international experience, rotation of auditors, where mandated, has been limited only to public interest entities. Further, this requirement is likely to create disruption, particularly for private companies which are subsidiaries of foreign companies since the auditors for the companies in India would differ from the global auditors of the foreign companies posing practical implementation difficulties.
4. Indian subsidiaries of overseas companies (ie, multinational companies), be excluded from the requirements relating to auditor rotation.
5. The thresholds of paid up share capital, public borrowings and public deposits is considerably low as compared with the thresholds used in other sections/rules across the Companies Act, 2013 (which range from Rs.100 to Rs.300 crores) and the requirement is likely to impact a large number of companies. Considering the significant impact on costs, time and efforts on the part of the companies as well as availability of chartered accountants, the thresholds need to be increased in line with the other thresholds across the Act and Rules.
6. Explanation 2(b) to Rule 6(3) of the Audit and Auditor Rules specifies restrictions which apply when a “partner who is in charge of an audit firm” and also certifies the financial statements of the company retires from the said firm and joins another firm. In that case, such other firm is also ineligible to be appointed for 5 years. The meaning of the phrase “partner who is in charge of an audit firm” should be clarified as to whether this would mean person in charge of the firm/branch office or the auditor-in-charge of the particular company in question.
7. For companies to which auditor rotation applies, implementation should be done in a phased manner in order to prevent significant hardship on such companies.

67. Eligibility, qualifications and disqualifications of auditors - Financial interest and indebtedness, guarantee or security

A person will not be eligible for appointment if he himself, his **relative** (defined as below) or partner

- i) holds any security or interest in the company, or its subsidiary, holding or associate company or subsidiary of such holding company. However, the relative is allowed to hold security or interest in the company having face value not exceeding Rs. 1 lac.
- ii) is indebted to the company, its subsidiary, holding or associate company or subsidiary of such holding company, in excess of Rs. 5 lacs
- iii) has given any guarantee or provided any security provided in connection with indebtedness of any third person to the company, or its subsidiary, holding or associate company or subsidiary of such holding company, in excess of Rs. 1 lac.

The term “relative” is defined as below:

- (i) Members of a Hindu Undivided Family
- (ii) Husband and wife
- (iii) Father (including step-father)
- (iv) Mother (including step-mother)
- (v) Son (including step-son)

- (vi) Son's wife
- (vii) Daughter
- (viii) Daughter's husband
- (ix) Brother (including step-brother)
- (x) Sister (including step-sister)

Such definition may have significant impact on the appointment criteria and qualifications of the auditor. It could:

- Unintentionally affect situations where such investments are held by the said relatives inadvertently
- Be used to intentionally impair an individual's ability to be appointed as auditor (say, by an estranged relative)

A person may not be able to control/influence a relative unless such other person is financially dependent on the former. It would be impractical to obtain information from financially independent relatives other than wife/husband. Further, restraining such a long list of relatives from transacting as aforesaid, especially if they are financially independent, is also not practicable.

Suggestion

We recommend that, for the purposes of clause 141(3)(d), the term "relative" should be defined to include "spouse or dependent relative" and is in line with IESBA Code of Ethics. The term 'dependent relative' may be explained to include any relative who received more than half of the financial support for the most recent financial year from the concerned person.

The rule should clarify that the definition of "interest".

Also the INR 1 Lakh limit for holding securities in the company by a relative should be significantly increased. INR 1 Lakh may be too restrictive in practice.

68. Business relationships

A person or firm will not be eligible for appointment, if it, directly or indirectly, has business relationship with the company, its subsidiary, its holding, or associate company or subsidiary of such holding company or associate company.

The term "business relationship" has been defined in the Rules to include any commercial transaction except i) permitted professional services and ii) commercial transactions which are in the ***ordinary course of business of the company*** at arm's length price, like sale of products or services to the ***auditor as customer in the ordinary course of business***, by companies engaged in the business of telecommunication, airlines, hospitals, hotels and **such other similar businesses**.

The term 'such other similar businesses' has not been defined and if it is taken to mean only the businesses of the type mentioned in the rule, it may have serious negative impact on the appointment criteria and qualifications of the auditor. For example: the auditor may be disqualified if he/she purchases a computer ink cartridge from the company owned showroom of the auditee company.

The phrase "in the ordinary course of business" highlighted above is likely to create some serious practical difficulties. The aforesaid phrases require that in order to be exempt, the commercial transactions must not only be at arm's length but must also be **in the ordinary course of business for both the auditee company and the auditor**. To explain further, if there is an audit client which is not a developer but has extra office space, the auditor cannot take it on rent even if he pays the market rate for it since such transaction is not in the company's ordinary course of business. This may not be the intention, but it is difficult to interpret differently, unless clarified otherwise. Likewise, if an audit firm wants to hire office space, that will be in the audit firm's ordinary course of business, but at the same time, if a partner wants to buy residential space from a developer audit client, that may be restricted since it is not in the auditor's ordinary course of business.

Suggestions

1. The term 'such other similar business' does not seem to be the intention as it literally reads. The rule should accordingly be modified to replace such term with 'any other business'. That is any transaction which is at arm's length with the auditor should be permitted.
2. The term 'in the ordinary course of business' also seems to be unintended and should therefore be done away with from both places in the definition contained in the rules.

69. Limit on maximum number of audits

A person or a partner of a firm will not be eligible for appointment, if such persons or partner at the date of appointment holds appointment as auditor of more than 20 companies. Private companies are included in the maximum cap of 20 companies.

Under the erstwhile Act/ICAI rules, an auditor could audit a total of 30 companies including private limited companies, out of which no more than 20 could be public limited companies. The current provisions are applicable with immediate effect on 1 April 2014. There will be several auditors who have more than 20 audits but less than 30 audits and correspondingly, there would be several firms with similar level of audits per partner.

Neither in other emerging economies such as Brazil, Russia, and China, nor in the rest of the world, including mature economies, there is any requirement similar to even what is currently there in the Act, in terms of a limit on the number of audits that an auditor / audit firm can undertake.

It appears that the legislative intent was to retain the limit as it exists in the current Act of 1956 which had the same limit of 20 but applicable only to public companies i.e. it excluded private companies from these limits.

If the above provisions apply with immediate effect, those auditors / audit firms with more than 20 audits (individually / per partner) will automatically stand disqualified from being appointed / reappointed as auditor of companies and it will result in casual vacancy in the office of the auditor. This will also force companies to search for replacement of auditors which, naturally, cannot be done immediately. This will cause significant hardship on both the auditor and the companies.

Further, since not all chartered accountants in full time practice are audit practitioners having relevant and sufficient audit experience, it may result in a situation where there is an insufficient number of chartered accountants who are audit practitioners, to audit all companies in India.

Suggestions

1. It should be clarified through the Rules that private companies will not be considered in determining this limit of 20 companies.
2. Further, it should be clarified whether or not one or more branch audits of the same company, where the branch auditor is not the auditor of the company's head-office, will be counted as one audit for the purposes of ascertaining this ceiling limit.
3. It should also be clarified that audit of consolidated financial statements would not be considered for computing the limit of 20 companies.
4. A rule prescribing transition period needs to be notified since the reduction in the aforesaid limit will cause auditors to be in breach of the limit made effective from 1 April 2014.

70. Additional reporting requirements - Reporting on Internal Financial Control Systems

As per Section 143(3)(i), the auditor has to now additionally state in his report whether the company has adequate **internal financial controls system** in place and the operating effectiveness of such controls. To assert that the system of internal control is adequate would require an audit of that system separately from the financial statements audit, similar to section 404 of SOX. This would result in an increase in time and costs involved in the audit.

The term “internal financial controls” has not been specifically defined for this purpose.

As per Section 134(5), the Director's Responsibility Statement, in the case of a **listed company**, is also required to state that the directors 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 given in this section states that, “***for the purposes of this clause***, the term ‘*internal financial controls*’ means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information. Hence, the 2013 Act lays down very wide responsibility on directors.

The Rules additionally require the Board Report, for unlisted companies, to contain the details in respect of adequacy of **internal financial controls with reference to the Financial Statements**. Thus, the above Rule introduces the requirement of internal financial controls to be addressed particularly with reference to the **financial statements**, which is different from the aforesaid auditor's responsibility with regard to “internal financial controls system”.

Suggestions

Auditors should be required to comment only the adequacy/ existence and operating effectiveness of internal financial controls pertaining to financial statements.

Internationally, USA and Japan are the largest economies where integrated reporting (ie, reporting on internal controls over financial reporting) exists. In those countries, such reporting is required only for listed companies, and some public interest entities. The application of such requirements to all

companies would cause significant hardship in complying with these requirements. Further, auditors in India are not yet experienced to handle such engagements involving reporting on internal financial controls, and hence, this would also be a significant challenge.

Hence, we recommend as below :

1. The scope of reporting by the auditor on internal financial controls should be clearly defined to be limited to internal financial controls relating to financial statements since there may be other areas of internal financial controls that do not impact the truth and fairness of financial statements.
2. Guidance for reporting on internal financial controls should be made available to auditors to enable them to undertake reporting responsibilities and to ensure there is consistency in the manner of reporting in this regard.
3. The requirement of reporting on internal financial controls by the auditors as well as by the directors should be restricted only to listed companies.
4. Use of letterhead for auditor's report, as required by Rule 13(3) is not in line with the ICAI's Code of Ethics and certain disciplinary cases. Clarification is required in this respect.
5. Form ADT-4, point 12, requires a Yes or No response as to whether the auditor is satisfied with the reply of the Board or Audit Committee. The auditor could be satisfied with some steps taken by the Audit Committee/ Board and not with others; and may want to describe the reasons for his response. A option for a descriptive response may be given to ensure effectiveness of the response.

71. Additional reporting requirements - Reporting on Frauds

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 is required to immediately report the matter to the Central Government within 60 days after following the procedure stated below.

The auditor is required to send his report to the Board or Audit Committee, as the case may be and obtain its reply or observations on such report within 45 days, and forward his report to the Central Government within 15 days thereafter alongwith his comments thereon.

Non-compliance is punishable with a fine of minimum Rs. 1 lac which may extend to Rs. 25 lacs.

Suggestions

Under the draft rules, reporting to the Government was required only for material frauds. Material frauds were defined as (a) fraud(s) happening frequently, or (b) fraud(s) where the amount involved or likely to be involved is not less than 5% of net profit or 2% of turnover of the company for the preceding financial year. For immaterial frauds, the auditor was required to report only to the Audit Committee/ Board.

In the final rules, distinction between material and immaterial frauds has been removed. The auditor will need to report on all frauds detected during the course of audit to the Central Government, irrespective of nature or amount involved. This casts an unduly high level of work and responsibility on the auditor to report on frauds which is not only impractical, but will not add any value.

Accordingly, we recommend the following :

1. In a normal business, there can be allegations, which are at various stages of investigations. Consequently, reporting requirement for the auditor should only be limited to those frauds which have been investigated and concluded and not merely allegations.
2. The materiality thresholds should be reintroduced in the rules, at least to the extent defined in the draft rules if not higher, to keep the auditor's reporting focused on material frauds.
3. The above requirement should also be accompanied by regulation to protect the auditor from criminal or civil liability. Globally, such protection is always accorded to the auditor, e.g. the US SEC's Order 10A or the OECD anti-bribery recommendations that state that a requirement to report bribes should be accompanied by protection for the auditor.

72. Prohibited services

The auditor can no longer provide the following services, directly or indirectly, to the company or its holding company or subsidiary company.

- a) accounting and book keeping services;
- b) internal audit;
- c) design and implementation of any financial information system;
- d) actuarial services;
- e) investment advisory services;
- f) investment banking services;
- g) rendering of outsourced financial services;
- h) management services; and
- i) any other kind of services as may be prescribed

The Act does not define the terms “investment advisory services”, “investment banking services” and “management services”, which may be subject to varying interpretations.

It is not clear if restrictions on rendering of services by the auditor or its network firm apply to the parent or subsidiary company if they are located outside India.

Suggestions

1. The definitions for these terms should be provided based on the definitions of such terms under various existing laws or regulations as given below:

As per the AICPA Code of Professional Conduct, **“Investment Advisory Services”** means (a) to make investment decisions on behalf of client management or otherwise have discretionary authority over a client's investments; (b) execute a transaction to buy or sell a client's investment; (c) have custody of client assets, such as taking temporary possession of securities purchased by a client.

“Investment Banking Services” may be defined based on the definition of Merchant Banking Services under the SEBI (Merchant Bankers) Regulations, 1992 as follows:

- (i) to carry on any activity in relation to a public issue of securities, which will inter-alia consist of preparation of prospectus and other information relating to the issue, determining

financial structure, tie-up of financiers and final allotment and refund of the subscription; and

- (ii) to act as adviser, consultant, manager, co-manager, underwriter, portfolio manager, consultant to a public issue of securities

“Management Services” means assistance for carrying out such services for the company which are the responsibilities of the management. As per IFAC Code of Ethics for Professional Accountants, “management responsibilities” means leading and directing an entity, including making significant decisions regarding the acquisition, deployment and control of human, financial, physical and intangible resources.”

- 2. It should be clarified whether the restriction will apply to rendering of non-audit services by the auditor or its network firm to the company’s holding company or subsidiary located outside India. It should be clarified that the restriction does not extend to a jurisdiction outside India.
- 3. Further, restrictions on services to subsidiary and holding companies should apply only to a subsidiary that is material to the auditee company, or to a holding Company if the auditee company is material to the holding company. Also, materiality limits may be suitably defined, for example, entity that contributes 10% or more of turnover or assets of the consolidated amounts.

73. Requirement – Appointment of Auditors

It has been clarified as an explanation to Rule 3 that if the appointment of auditor is not ratified by the shareholders, Board should appoint a new auditor.

Suggestion

It has to be clarified, in such case, what would be the process of removal of the earlier auditor, or is the office automatically terminated and vacated. Clarity is required from a procedural perspective.

74. Requirement - Transitional period of 3 years for auditor rotation u/s 139(2)

Section 139 reads as follows:

- (2) No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint -
 - (a) an individual as auditor for more than one term of five consecutive years; and
 - (b) an audit firm as auditor for more than two terms of five consecutive years:

Provided that—

- (i) an individual auditor who has completed his term under clause (a) shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term;
- (ii) an audit firm which has completed its term under clause (b), shall not be eligible for re-appointment as auditor in the same company for five years from the completion of such term:

...

Provided also that every company, existing on or before the commencement of this Act which is required to comply with provisions of this sub-section, shall comply with the requirements of this sub-section within three years from the date of commencement of this Act:

Rule 6 of the Companies (Audit and Auditors) Rules, 2014 deals with the manner of rotation of auditors by the companies on expiry of their term. The illustration in tabular form, given under this rule, contains the maximum number of consecutive years for which he may be appointed in the same company (including transitional period) in the second column of the table.

Suggestion

Having regard to the language of section 139(2), and the third proviso to that sub-section, and also based on a reading of the aforementioned Rule, it is understood as follows:

- The company has a total period of three years before which it needs to ensure that auditors are appointed under the requirements of Section 139(2) read with the Rules in that regard.
- During this transitional period of three years, it has an option to appoint its auditor for an annual term (of one year), rather than a block appointment, so long as after such three-year period is completed, the company has to mandatorily undertake only block appointments, for appointment of auditor.

It is submitted that the above understanding be clarified.

75. Requirement – Disqualifications

Section 141(3)(i) states that a person whose subsidiary or associate company or any other form of entity in engaged consulting and specialized services as provided in section 144 shall not eligible for appointment as an auditor for a company. The language of 141(3)(i) is such that a firm which is engaged in any of these activities mentioned in section 144 anywhere in the world and is rendering such services to companies other than the auditee company cannot be appointed as auditor of a company in India even if such services are rendered to an entity which is totally unconnected with the auditee company.

Suggestion

This must be be clarified to say that the services referred to in section 141(3)(i) are only in relation to services rendered to the company that proposes to appoint the auditor.

76. Requirement – auditor’s report

The auditor’s report shall also state –

143(3)(a) : whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;

Suggestion

The following should be clarified through the Rules in this context :

- 143(3)(a) : Details of how the audit is to be performed should be left to the Auditing standards. The discretion to report issues is best left to the judgment of the auditor.

77. Requirement – additional reporting requirements

Section 143 (3); Rule 11: For the purpose of, this Rule stipulates additional reporting requirements on the auditor including disclosure of effect of pending litigations; provision for foreseeable losses, if any, on long term contracts including derivative contracts and deposits in Investor Education and Protection Fund.

Suggestions

The aforesaid requirements are already contained in the Accounting Standards i.e. AS-29 and AS-7/AS-1 for (a) and (b) respectively. The auditor is required to specifically report, whether or not in his opinion, the financial statements comply with accounting standards. Hence the need for separate reporting on the above matters is not essential.

Further, it is not clear, whether the reporting requirements of CARO are going to be issued as separate rules, in which case the requirement relating to deposit in IEPF may be covered therein.

78. Requirement – Professional Misconduct

Section 132 (4): This section provides that the entire firm may be debarred from practice by NFRA for 6 months to 10 years if proved guilty of professional misconduct.

Suggestion

It should be clarified through the Rules that the entire firm will not be barred unless majority of the partners including the firm's leadership directly and substantially participated in the misconduct. Further, the manner in which the investigation shall be carried out before deciding any person as guilty of professional misconduct has also not been prescribed, which should be done.

79. Requirement – Conviction

Section 147(3): This section provides that if an auditor is convicted of contravention of specified provisions of the Act, he shall be liable to refund the remuneration received and pay damages to the company, statutory bodies or authorities or to “any other person” for the loss arising out of incorrect or misleading statements in his report.

Section 147(5) states that the partners and firm liable for civil and criminal liability jointly and severally. Rule 9 of the Companies (Audit and Auditors) Rules, 2014 states that liability other than fine, will devolve only on the concerned partner or partners who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud.

Suggestion

It is important to note that though the phrase “any other person” has been deleted from Section 147(2) of the Act, the same has inadvertently not got deleted from Section 147(3). The view even in the advanced countries like UK is that the auditor would be liable only to a reasonable, limited and identifiable group of users that have relied on his work (e.g., creditors) even though these persons were not specifically known to the auditor at the time the work was done. [Caparo Industries plc v/s Dickman & Others].

Further, since the rules cannot override the requirements of the section, this section will need to be modified suitably.

80. Requirement – Duty to attend AGM

Section 146 casts a duty on the auditor to attend every general meeting of the company unless otherwise exempted by the company. This Section mentions that the auditor shall attend either by himself or through his authorised representative who shall also be qualified to be an auditor.

Suggestion

The terms “also be qualified to be an auditor” requires clarification as only a person with a practicing license is qualified to be an auditor but most firms of auditor have senior employees who are Chartered Accountants but cannot sign audit reports since they do not have the license to practice. Whether such senior managers who are Chartered Accountants can attend general meetings need to be clarified.

81. Requirement – internal auditor

The Rules provide for the class of companies that shall be required to appoint an internal auditor or a firm of internal auditors

Suggestion

Inclusion of Companies (alongwith firms) to act as the internal auditors of the companies should be considered and it should be clarified that a company may be appointed as internal auditor if the Board of directors deems it as professional organization.

COMPROMISES, ARRANGEMENTS AND AMALGAMATIONS

82. Requirement – Clarification of multiple issues

There are multiple issues with respect to Compromises, Arrangements and Amalgamations that need clarity.

Suggestion

- According to section 230, Person making takeover offer must enter into MOU with shareholders of the company being acquired. It is not clear with what percentage of total shareholders MOU is to be entered into.
- According to section 230, if acquired company has any term loan outstanding prior approval of lender will be required before passing special resolution. It is not clear whether the approval required to be obtained is from all lenders or there is any monetary limit.
- As per Section 230, if consideration of shares to be taken over is being paid otherwise than by cash, valuation of such consideration to be done by registered valuer. The valuation report has to be sent along with notice. The question is since valuation report will contain detailed particulars of the company, will the sending of valuation report not put the confidential information about the working of the company in the public domain.

- According to section 230, for restructuring, consent of 75% of the Secured creditors is needed as against 3/4th of the all creditors in the old law, which means that the consent of secured creditors will bind unsecured creditors in restructuring under the Act of 2013.
- According to Section 232 read with Rule 15.24, Applicability of Rules to the Amalgamation of Sick Company, the Tribunal may order for amalgamation of a company with any other if the Tribunal is satisfied that such amalgamation is economically and strategically viable for the amalgamated company and such resultant company will remain financially sound even after such amalgamation. Since there is a separate Chapter-XIX on Revival and Rehabilitation of Sick Companies, Rule 15.24 appears to be an anomaly.
- The use of word ‘shall’ in the section 236 (1) makes it mandatory for the majority shareholder to buy out the minority shareholders even if by mutual consent the majority and the minority shareholders wish to continue to remain as shareholders in the company.
- As per section 236, the majority shareholders shall deposit the value of the shares to be acquired in a separate bank account to be operated by the Transferor Company. The bank account will be kept open for one year for unclaimed amounts. In case minority shareholder has died or ceased to exist, successors/heirs can take benefit of this opportunity for a period of three years from date of majority acquisition. After expire of three years what will happen not is clarified either in the Act or in the Rules. And the term ‘Transferor Company’ is not clear and seems to be an anomaly.
- Section 236 provides that in case 75% of the minority shareholders negotiate a higher price for the members, the additional compensation shall be shared with balance minority shareholders. The drafting of this section raises many unanswered questions such as what if the other shareholders have already been paid, method of communication and sharing etc.
- As per rule 15.31 read with section 240, in case of Demerger, in the books of demerged company assets and liabilities shall be transferred at book values without considering revaluations or write-off carried out during last two years. Reason for non-consideration of revaluation or write off not clear. Non consideration of write- off will be a clear violation of accounting standards.

83. Requirement – Lack of clarity of certain terms

In a large number of sections, terms have not been defined.

Suggestion

Clarity needs to be given to:

- Section 129(3), Explanation to second Proviso requires joint ventures to be included in consolidated financial statements. The term joint venture is not defined in the Act or in the Rules.
- In Section 230, the term “regulated” is not defined and may raise issues such as whether permission of Tea Board (which is mentioned in the Tea Act 1953 and regulates the tea industry) will be required for an acquisition of tea garden.
- Section 232 mentions that if the transferor company is a listed company and the transferee company is an unlisted Company Tribunal may order that the transferee company shall remain an unlisted company until it lists itself and in such case if shareholders of the transferor company decide to opt out of the transferee company the Tribunal will make provision for payment of

value of shares held by them and other benefit. The term ‘other benefit’ has not been defined in the Act or in the Rules.

- As per section 232, for the meeting to be called for the purpose of amalgamations etc. report is to be adopted by the Boards of the merging companies explaining effects of the compromise on each class of shareholders, key managerial personnel etc. The meaning of ‘effect of compromise’ is not clear nor is it explained anywhere in the Act or in the Rules.
- Section 233 provides, in the mergers of certain companies a Tribunal order will not be necessary if, among other conditions, notice of proposed scheme inviting objections, etc. are issued to Registrar, official liquidator or persons affected by the Scheme by both transferor and transferee company. The term “persons affected by the Scheme” is not defined in the Act or in the Rules.
- Section 236 provides that if an acquirer or person acting in concert with such acquirer becomes owner of 90% of shares in a company by virtue of amalgamation, share exchange, conversion of security or for any other reason, they shall notify the company of their intention to buy remaining shares. The term “Other Reason” is not defined in the Act or in the Rules.
- The following terms used in section 247 are neither defined in the Act nor in the Rules:
 - “continuous experience”
 - “financial valuation”
 - “technical valuation”
 - “other professional bodies”
- In Section 253, the term “Sick Company” used in this section has not been defined either in the Act or in the Rules.
- In Section 254 the term “Financial Asset” used in the section is not defined in the Act or in the Rules.

SHARES CERTIFICATES / TRANSFERS

84. Requirement - Committee for approving transfer of shares

Rule 5(1) of the Companies (Management and Administration) Rules, 2014 requires that entries in the Register of Members maintained under Section 88 of the Act shall be made within seven days after the Board of Directors or its duly constituted committee approves the allotment or transfer of shares.

Suggestion

Clarification is required as to whether transfer of shares can be approved only by a committee comprising directors or can such committee also comprise company executives as was permitted under the Companies Act, 1956.

If the view is that such committee should comprise directors only, completion of share transfers may get unduly delayed as it may not be possible for the directors to meet frequently.

85. Requirement – Issue of Duplicate Share Certificates

- The issue of duplicate share certificates has suddenly become so sensitive, since sec 46 imposes a whopping penalty of Rs 10 crores for a breach of the section. The rules now lay a peculiar requirement - a company cannot issue duplicate shares “without prior consent of the Board”; at the same time, the Rules say that the duplicate shares must be issued within 15 days from the date of submission of documents. These twin requirements will be impossible to comply with, as board meetings cannot be called within 15 days for sure. From the wording of the Rule, it does not seem that the power may be delegated to a committee.
- Rule 6(2)(a) of the Companies (Share Capital and Debentures) Rules, 2014 provides that duplicate share certificates shall not be issued in lieu of those that are lost or destroyed, without payment of such fees as the Board thinks fit.

Suggestion

- The power needs to be delagated to a Committee.
- It needs to be clarified that Rule 6(2)(a) does not make it mandatory for the Board to charge fee for issue of duplicate share certificates.

86. Requirement - Signing of Share Certificates

In terms of Clause 5(3) of the Companies (Share Capital and Debentures) Rules, 2014, Share Certificates shall be signed by the secretary or any person authorised by the Board for the purpose. Provided that, in companies wherein a Company Secretary is appointed under the provisions of the Act, he shall be deemed to be authorised for the purpose of this Rule.

Suggestion

In a company with a large number of shareholders, it may not be practically feasible for the company secretary to sign **all** the share certificates himself, particularly in situations of corporate actions like bonus issue, rights issue, stock split, merger, demerger etc., where thousands of share certificates are required to be issued within specified timeframes.

In this context, clarification is required as to whether company officials, besides the company secretary, can be authorised by the Board to sign the share certificates of the company.

87. Requirement - Transfer Deed

Clause 11(1) of the Companies (Share Capital and Debentures) Rules, 2014 prescribes that an instrument of transfer of securities held in physical form shall be in Form No. SH. 4. Rule 3 requires companies to maintain information in the Register of Members (in Form No. MGT 1), including details such as Corporate Identification Number / Registration Number, Unique Identification Number, PAN Number, Nationality of shareholders, etc. In the prescribed Securities Transfer Form (Form No. SH.4) there is no provision to incorporate information in respect of Corporate Identification Number / Registration Number, Unique Identification Number, PAN Number, Nationality of shareholders, etc.

Suggestion

Clarification is required whether companies should accept or reject Transfer deeds which were executed by shareholders / investors prior to 1st April, 2014 in the erstwhile Form 7B and are received by the company on or after 1st April, 2014.

Also, Form No. SH.4 be appropriately modified to capture the information now mandated for incorporation in the Register of Members.

DIVIDEND

88. Requirement - Dividend Related

Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014 provides that in the event of adequacy or absence of profits in a year, a company may declare dividend out of surplus / reserves subject to the fulfilment of conditions.

Suggestion

- The word ‘**adequacy**’ in Rule 3 seems to have been mentioned inadvertently and needs to be corrected to ‘inadequacy’.
- In this regard, the draft Rule clearly mentioned that these provisions will apply only for the payment of dividend “out of amounts transferred to the reserve”. MCA should clarify that these requirements are to be followed only in the case of payment of dividend out of the amounts transferred to “Reserves”, and not payment of dividend out of P&L balance. Companies must have the freedom of utilizing the balance standing in the P&L account (not transferred to the reserves) for payment of dividend in case of inadequacy of profit in the year.
- It is provided that no company shall declare dividend [unless carried over previous losses and depreciation not provided in previous year are set off against profit of the company of the current year the loss or depreciation, whichever is less], in previous years is set off against the profit of the company for the year for which dividend is declared or paid. The sub-rule as it stands today is unclear and appears to provide duplicate language as regards the setting off of previous year’s losses and depreciation.

89. Rules on transfer of unpaid dividend to Investor Education and Protection Fund

There is need to provide a clarification for an exemption in cases of disputes over title to the shares and cases where ownership/ title to the shares is pending in courts.

FOREIGN COMPANY

90. Definition of Foreign Company

Section 2(42)(i), defines the term “Foreign Company” to include a foreign company having a place of business in India through an agent or through electronic mode. Rule 2(c)(i) of the subject Rules

provides that “electronic mode” includes business to consumer transactions, but it is not clear whether supply of physical goods pursuant to online transactions would be included within the scope, considering that the rest of sub-clauses envisage only the supply of online services or data.

Further, the Rules are silent on the procedure to be followed in cases of establishment of place of business through an agent. In both cases (online business and agency), the foreign company would have no details to provide in Form FC-1, as regards its principal place of business in India since it may not even have a place of business in India.

Section 391 (2) of the Act states that the provisions of Chapter XX shall apply mutatis mutandis for closure of the place of business of a foreign company in India as if it were a company incorporated in India.

The place of business of a foreign company in India will usually be through a Liaison Office/ Project Office/ Branch Office, which is already subject to the regulation by the Reserve Bank of India (RBI).

Suggestion

It is suggested that the above understanding may be clarified. Also, whether compliance with the RBI requirements in such instances would be considered sufficient.

MISC SUGGESTIONS / CLARIFICATIONS

91. Requirement - Information required on Letterheads etc.

Section 12(3)(c) of the Act provides that every company shall get its name, address of its registered office and the Corporate Identity Number along with telephone number, fax number, if any, e-mail and website addresses, if any, printed in all its business letters, billheads, letter papers and in all its notices and other official publications.

Suggestion

It is not practically possible to change all letter heads/papers immediately so some transition period of 3 months w.e.f 1st April, 2014 should be given.

It is common practice in corporate India that some operating units and other offices viz. administrative office, marketing branch etc. of a company have their own email addresses. In this context, it needs to be clarified that in such cases, providing the email address of the respective unit would suffice. Moreover, there could be some small units / offices of a company which may not have any email address. It needs to be clarified whether such units would mandatorily need to have an email address.

92. Requirement - Vigil Mechanism

No threshold has been prescribed as far as deposits from the public is concerned. Further, borrowing threshold of INR 50 crores (which covers only borrowings from banks & public financial institutions) is low and may be considered for upward revision. It is not clear whether the thresholds prescribed under Rule 7(1)(a) and 7(1)(b) are to be read together (in which case they should be separated by the

word “and) or they are disjunctive, i.e., refer to separate classes of companies (in which case they should be separated by the word “or”).

Suggestion

Borrowing threshold is low and should be raised as otherwise this will cover even small private companies. Clarity is required as otherwise this remains open to interpretation by regulatory authorities and / or companies.

An indicative list of what constitutes “adequate safeguards” to prevent victimization of employees / directors should be provided in the Rules. Safeguards are critical for success of a vigil mechanism of the kind envisaged under the rules. Hence, the same should be spelt out in the Rules to prevent any ambiguity on level of safeguards required.

93. Transition provisions (Section 465(2)(a))

Clarification is required to confirm that transactions, resolutions and agreements validly entered into under Companies Act, 1956 prior to the effective date of the respective sections of the Companies Act, 2013 will continue to remain valid till the subsistence of those transactions/ agreements/ limits of approval, etc.

In addition, most of the major section of the new Act and Rules framed thereunder were notified by uploading on the MCA website in the last week of March - mostly on 30th and 31st March 2014 and which was made effective from April 1, 2014 but the transition time given for the corporates for complying with the new clauses was just a day or two.

A transition period of minimum six months should be given overall so that sufficient time is available for the Corporates to comply with the changed norms. This will be extremely helpful, given that any default on part of compliance, is attracting heavy penalty and hence the need of staggered and specific roll out calendar becomes a need of the day.

94. Requirement Proposed Form DIR-3:

A person can be appointed as director only if he possesses a DIN under section 152(3) & Rule 9(1) of Chapter XI. From April 1, 2014 till April 14, 2014 e-filing of DIR-3 is unavailable in MCA portal due to transition work.

Suggestion

If a person needs to be appointed as a director during this transition period, it needs to be clarified whether the DIR-3 for obtaining his DIN can be filed after such appointment and after enabling e-filing. Many directors, especially foreign directors, are not signatory of a company and hence do not possess digital signature, whereas the Form DIR-3 requires digital signature of the applicant who would be a prospective director in a company. This may be changed such that the authorised official of the company, in which the applicant is proposed to be appointed, digitally signs the Form DIR-3.

Cancellation or surrender or deactivation of DIN: It is recommended amending the definition of “fraudulent means” provided in the said Rule. The definition of ‘fraudulent’ is different from that

provided under Section 447 of the Act. The definition should be amended to include the intent to deceive the company and the shareholders.

95. Appointment of Company Secretary

Chapter XII has specified that every listed Company and every other public Company having a paid up share capital of Rs. 10 Crores or more shall have a whole time Company Secretary, whereas the previous Act required every company having a paid up capital of Rs. 5 Crores to have a whole time company secretary. Company Secretaries are regulated professionals and they render services critical for companies. A company needs a Company Secretary to strengthen its governance and compliance. Hence, increase in the limit is unjustifiable and the earlier limit should prevail.

96. Suggestion for setting up a cell / platform to provide guidance and clarifications on the implementation of Companies Act, 2013

With the recent notification of the Act and rules and forms thereunder, there are bound to be challenges for stakeholders' viz. Corporates, Practicing professionals etc. on the implementation. Stakeholders will require clarifications / guidance of Ministry from time to time.

Currently, there are no formal procedures or window available to the stakeholders to obtain clarity or guidance from the Ministry. Therefore, it is suggested that the Ministry should create a Cell and lay down formal procedures through which the stakeholders may approach the Ministry for seeking guidance on the issues regarding the implementation of the Act specifically, the matters relating to Interpretation of provisions of law.

The Ministry may notify detailed rules in this regard inter-alia mentioning the procedures, prescribed fees, timelines etc. on similar lines as existing SEBI (Informal Guidance) Scheme, 2003.

97. Need for Exemptions for Section 8 Companies [companies with charitable objects, etc.]

Section 8 of the new Act is akin to Section 25 of the old Companies Act which prescribes the provisions dealing with setting up of companies with charitable objects, etc.

It may be noted that the basic intent of setting up of these companies is to conduct charity; promote commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment etc. Given the overall benefit to the cause for which these companies are set-up and the restrictions placed on their operations, these non-profit organisations were exempted from the rigors of stringent compliances under the 1956 Act.

CII strongly suggest that the benefits extended to this class of companies be reinstated in the new Act as well. In addition, they should also be exempted from rigorous compliance provisions introduced by the Companies Act, 2013 such as appointment of independent directors, woman director; rotation of auditors; constitution of multiple committees; performance evaluation, etc.

Also, directorship in Section 8 companies must be excluded from the total permissible number of directorships held by an individual. This must be reinstated in the new Act on the lines of

the 1956 Act (whereby Section 278 specifically excluded an association not carrying on business for profit or which prohibits payment of dividend from directorships).

98. Implementation issues with respect to Depreciation [Section 123 and Schedule II]

Section 123(1) of the Companies Act, 2013 (the 'Act') states that no dividend shall be declared or paid by a company for any financial year except out of profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2). Section 123(2) requires depreciation to be provided in accordance with the provisions of Schedule II.

In Part I, the amended paragraph 3(i) states:

“(i) The useful life of an asset shall not be longer than the useful life specified in Part ‘C’ and the residual value of an asset shall not be more than five per cent. of the original cost of the asset:

Provided that where a company uses a useful life or residual value of the asset which is different from the above limits, justification for the difference shall be disclosed in its financial statement.”

There are certain practical difficulties with respect to ascertaining the requirements of the above provisions. Hitherto, the understanding with respect to Schedule XIV to the Companies Act, 1956, was that the depreciation rates prescribed therein are the minimum rates that have to be complied with. This was also clarified in Circular 2 of 1989 dated 07.03.1989.

However in paragraph 3(i) referred to above, while the first sentence states that the useful life of an asset cannot be longer than the useful life specified in part 'C', the proviso to the paragraph has created an ambiguity. The proviso requires that where a company uses a 'different' life from the specified limits a disclosure of the justification needs to be given. This appears to indicate that a different life can be followed and further such different life can either be a shorter or longer life, with the only requirement being that the same should be justified.

Suggestion

We request that a clarification is provided as to whether the useful lives as provided in Schedule II are the maximum useful lives (resulting in minimum rates of depreciation) or whether the useful lives as prescribed in Schedule II are only indicative useful lives and as long as justification is disclosed in the financial statements for deviation from them, it would be sufficient compliance with the requirements of Schedule II.

99. Need for Exemptions for Private Companies

CII has submitted a detailed representation on this to MCA on 10 December, 2013. Inclusion here is intended at reiteration of the recommendations given their significant impact of the new regime on private companies.

The Companies Act, 2013 has prescribed various stringent provisions for companies including private companies. These include many new concepts included for the first time in law and also provisions that were not applicable to private companies under the 1956 Act. Some of these include rotation of auditors, directors, provisions relating to loans and investments, insider trading, etc.

CII is of the opinion that private companies - which are neither subsidiaries of listed companies nor have substantial borrowings (as may be defined) from banks or financial institutions - should be exempt from some of the stringent provisions of the Act. Applicability of these provisions, as are listed hereunder, tantamount to treating such private companies at par with other public interest entities.

It is humbly submitted that such class of private companies, as may be prescribed, be kept out of the purview of the following sections, either through exemption notifications under section 462 or through the Companies Rules, as may be appropriate:

Section	Provision	Rationale
62	Further Issue of Share Capital	Considering the limited number of members a private ¹ company can have, imposition of these restrictions would only create unnecessary compliances and procedural delays for private companies.
92	Annual Return	The information required to be provided is too detailed and too cumbersome for a private company to furnish.
101-109	Provisions regarding General Meetings	While the procedures set out under these sections serve a purpose for public companies and other public interest entities, in case of private companies, these would only cause unnecessary delays without commensurate benefits.
110	Postal Ballot	In view of the limited membership of the private companies, this requirement may be unnecessary.
134(3)	Statements required to be attached to the report of the Board of Directors	The statements are too detailed and for a private company too cumbersome to furnish.
137	Copies of financial statements to be filed with the Registrar	Profit & Loss Accounts of private companies were not treated as public document under the 1956 Act and such a privilege should be continued under the new law.
139	Rotation of auditors	In case of companies with no public interest, the requirement is unnecessary.
149(1)	Requirement to have a Woman Director	In case of companies with no public

¹ Reference to a private company in this point means a private company, which is neither a subsidiary of a listed company nor has substantial borrowings (as per thresholds that may be specified) from banks or other financial institutions.

	on Board	interest, the requirement is unnecessary. Boards of private companies should have the prerogative to decide upon its directorships.
152, 161, 162	Requirements to file consent, retirement by rotation, filling of casual vacancy, additional directors	In case of companies with no public interest, these requirements are unnecessary.
160(1)	Requirement to deposit Rs 1 lakh along with the proposal signifying candidature of a person other than the retiring director to stand for directorship	In case of companies with no public interest, the requirement is unnecessary.
170	Register of directors and key managerial personnel and their shareholding, filing of return with RoC	This requirement entails unnecessary compliance.
173(3)	Requirement of giving 7 days' notice for a meeting of the Board	Private companies are closely held and managed by family members. Further these are not obligated to appoint independent directors. In view thereof, this requirement would be cumbersome and restrictive.
180	Restrictions on power of the Board	Since shareholders in a private company are usually its directors and their relatives, such restrictions are unnecessary in case of companies with no public interest.
185	Loans to Directors, etc.	In case of companies with no public interest, the requirement which prohibits giving loans to directors, not even with shareholders' approval, is restrictive.
186	Loans and investments by a company	Private Companies with no public interest should be allowed to operate in accordance with their internal policies and should not be obligated to follow the same compliances as are applicable to other public companies.
188	Related Party Transactions	In private companies with no public interest, such requirements are rather cumbersome. Further, such restrictions could lead to deadlocks where the directors and their relatives are shareholders too and thus prevented from voting on the transactions.

195	Prohibition on Insider Trading of Securities	<p>The consequence of applying principles of prohibition of forwarding trading or insider trading to unlisted companies, which do not have published information can affect their ability to raise funds. SEBI has on 3rd October, 2013 vide notification issued under Section 16 and 28 of the Securities Contract Regulation Act, 1956 clearly demonstrated that the option agreements, wherein the valuation is determined based on price sensitive information of unlisted companies, where there is no publication of such information required, do not get affected.</p> <p>Additionally, it may be noted that ‘insider trading’ is not relevant from the perspective of a private company and unlisted public company (except where such public company intends to get its shares listed) as the shares of such companies are not traded on any stock exchange, and the person, who has any price sensitive information, cannot use such information in ‘deal in such securities’.</p>
203	Appointment of Key Managerial Personnel	In case of non-public interest entities, company should have the discretion to decide whether to appoint KMPs or not depending on the scale of operations.
245	Class Action	Given the shareholding pattern of the private companies under review, this level of investor protection would not be required and would only protract resolution of matters.

Some additional suggestions on The Companies (Corporate Social Responsibility Policy) Rules, 2014²

Introduction

Notification of Section 135 of the new Companies Act, 2013 in March 2014 by the Ministry of Corporate Affairs, has paved the way for the mandatory CSR regime in the country. As per the new requirement, every company having net worth of Rs 500 crore or more, or turnover of Rs 1000 crore or more or a net profit of Rs 5 crore or more during any financial year shall spend at least 2% of its average net profits towards CSR activities starting April 2014. The Companies (CSR Policy) Rules, 2014 clarify that every company, its holding or subsidiary, and a foreign company as defined under the Act having its branch office or project office in India, which fulfills the criteria mentioned above shall comply with the Act and the Rules.

Industry concerns

The industry has raised the following issues with respect to the Companies (CSR Policy) Rules:

1. **Limited scope: Restrictive since ‘CSR’ is subject to various interpretations**

By way of Rules, “Corporate Social Responsibility (CSR)” has been defined to mean and include (but not be limited to) project or programs relating to activities specified in schedule VII to the Act; or project or programs relating to activities undertaken by the Board of Directors of a Company (Board) in pursuance of recommendations of the CSR Committee as per declared CSR policy of the Company; subject to the condition that such policy will cover subjects enumerated in schedule VII of the Act.

The Rules limit the scope of CSR activities to those enshrined under Schedule VII only. Restricting CSR to the activities listed in Schedule VII makes it extremely restrictive. This is also since ‘CSR’ is subject to various interpretations and as yet does not have a universally accepted definition.

For companies to be able to creatively innovate and integrate CSR strategies within their businesses, corporate boards should be able to determine the constituents and objectives of the Company’s CSR initiatives. It is only then that a company would be able to create enduring sources of livelihood and other societal value through these initiatives.

Suggestion:

It is thus suggested that “Company subject to the condition that such policy will cover subjects enumerated in schedule VII of the Act” appearing in the definition in the last part should be deleted.

2. **Prescriptive Rules**

CII had originally opposed mandatory inclusion of CSR in the law, representing that the law should, at best, provide an enabling framework rather than a narrow and prescriptive one for

² In addition to the detailed representation of March 2014

encouraging corporates to undertake CSR responsibilities. Nevertheless, it was decided to introduce the provision as part of the law with the stated intent to provide a structured framework to the activities that companies are able to undertake through their profits.

Industry is apprehensive that implementation of this provision is bound to throw up challenges because of the rather prescriptive manner in which the Rules have been drafted. There is huge practical concerns on flexibility within legitimate boundaries, and how the monitoring and interpretation of companies' efforts will take place.

For example, being overtly prescriptive, it has been specified that companies must give preference to local areas where they operate. Such requirements with respect to what would constitute CSR and where it needs to be undertaken, may unsettle ongoing projects and initiatives. Not only that, it may also stifle innovation since companies would be bound to undertake only those activities that are specified in the Act and Rules.

3. Taxation

The new rules do not provide clarity on the taxation front for companies. There is no reference to tax treatment of CSR expenses - something that falls under the exclusive domain of the Income Tax law. There needs to be clarity and alignment of the Rules with the existing income tax regulations. The question is whether CSR spend - now mandated by law – can be treated as a business expenditure.

Moreover, net profit has been defined in Section 135 giving reference of Section 198, while in the Rules, further provisions have been provided. In case of overseas branch offices etc, where net profit is not calculated separately; how would the deduction in respect of overseas profits would take place, has not been clarified.

4. Immediate and Extended coverage

The Act provides that every company having net worth beyond the prescribed thresholds, during any financial year, shall spend at least 2% of its average net profits towards CSR activities. Whereas Rule 3(1) prescribes that every company, its holding or subsidiary, and a foreign company as defined under the Act having its branch office or project office in India, which fulfills the criteria specified, shall comply with the provisions of Section 135 of the Act and the CSR Rules. The Rules in this regard are applicable 1 April, 2014 – which is extremely challenging for companies to follow. Asking the companies to spend 2% of average profits of the preceding 3 years has come at a time when most of the sectors in the Indian industry are passing through tough times and therefore, the effective date of the provisions on CSR should be shifted to become effective 3 years from now.

On extended coverage, it is unclear if the Rules seek to extend the obligations of section 135 of the Act to the holding and subsidiaries of the company meeting the criteria, irrespective of whether the holding or subsidiary companies individually meet the criteria or not. This does not seem to be intention of the legislation, it is thus requested that a clarification be issued to remove the ambiguity. Moreover, the net profit threshold limit of mere INR 5 crore will bring majority of companies under the CSR net and this needs re-consideration.

It may be noted that Section 135 of the Act is applicable only to “company” which is defined in Section 2(20) as a ‘company incorporated in India under this Act or under any previous company law’. A ‘foreign company’ as defined under the Act is not covered. However, the CSR Rules have specified that the CSR compliance would also need to be done by a foreign company as defined under the Act having its branch office or project office in India. This seems to be beyond the mandate of Section 135 of the Act and needs to be reconsidered.

5. Requirement of registered trust / registered society

The Rules state that the Board of a company may decide to undertake its CSR activities approved by the CSR Committee through a registered trust or a registered society or a company established by the company or its holding or subsidiary or associate company under section 8 of the act or otherwise.

Except in the states of Maharashtra and Gujarat, the requirement for registration of a Trust as an entity does not exist. In all other States, only the Trust Deed is required to be registered. Accordingly, Trusts (whose deed is only registered) may not be eligible to undertake CSR initiatives on behalf of third parties, even though these may be well-established and well-functioning. It is thus requested that trusts registered under Income Tax Act, 1961 be considered as registered trusts and eligible in terms of Rule 4(2).

It also needs to be clarified whether this provision is also applicable to Section 8 companies which are already engaged in charitable or social activities. Rule 4(2) authorizes the Company to contribute to a trust or the company established under section 8 of the new Act. It is proposed that they should also include under section 25 of the erstwhile Companies Act, 1956.

Rule 4(2)- The Board of the Company may take CSR activities approved by CSR Committee, through a Registered Trust or a registered society or a company established by the company or its holding or subsidiary or associate company under section 8 of the act or OTHERWISE.

1. What OTHERWISE stands for needs to be clarified
2. Whether the company can implement the CSR Projects other than through the above bodies (Trust, Society or company) as AOP, BOI, Self etc.
3. Whether the criterial for 3 years Track Record etc to be checked for AOP, BOI, Self etc or it is only to be checked for Trust, Society or Trust.

In Rule 6 (1)(a) it is required to mention in Policy the Modalities of Execution of Projects and Implementation Schedule.

It is not possible to mention the Implementation Schedule in the Policy itself. We can only mention the programs to be undertaken along with the modalities of execution. The projects can be undertaken from year to year basis and the implementation Schedule will depend on that only. As the Policy to be of Permanent Nature it is not practically possible to mention the implementation Schedule.

6. Inclusion of Non-Academic TBIs under Schedule VII

Schedule VII lists 10 areas in which companies can undertake activities in discharge of their CSR obligation viz. education, rural development, women and child welfare, sports and incubation. The clause on incubation reads "contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government."

While this appears fair for states which have incubators say at IITs or IIMs, it will pose serious challenge for states which do not have these institutions and are supported by other institutions/ local incubators. Many of the competent Technology Business Incubators (TBI) are not functioning in an academic institution though they may be approved and supported by the Department of Science and Technology. These TBIs have been contributing to the economic development of the country by generating thousands of new-generation entrepreneurs and thereby creating employment and new products and services which directly contribute to the exchequer. Many of these TBIs have also been taking up Social Projects and serving people at the bottom of the pyramid.

It is thus suggested that the current form of Schedule VII be suitably modified to delete the requirement for technology incubators to be located within academic institutions.

7. Corpus under Rule 7

It is stated that CSR expenditure shall include contribution to corpus for projects or programs relating to CSR activities. It may be clarified whether this would also include contributions to the corpus of trusts. Clarity is also requested on disclosure of amount contributed by the company towards CSR but remaining unspent in the hands of the Section 8 Company etc. entrusted with undertaking the project

8. Track record

Rule 4 permits contribution to Trusts which have an established track record of 3 years in undertaking similar projects or programs. The meaning and interpretation of the terms "established" and "similar" needs to be explained and made clear. For instance, it needs to be clarified whether an e-learning for primary school and starting a college can be treated as "similar" in the sense that both relate to the broad objective of education.

9. Issues of Interpretation

Industry will be faced with many opportunities of conducting socially responsible activities. However, for some of them, there may be a need to clarify if these qualify as CSR under the provisions of the new Act and the CSR Rules. Some such instances are:

1. Rainwater harvesting within factory premises where the company does not use this water.
2. Renewable / Solar energy installations within factory premises for business consumption where the company chooses solar energy in the interest of the environment even though it is more expensive than grid electricity.
3. Capacity building of farmers on good agri-practices

4. Constructing roads in towns
5. Agricultural extension activity for improving farmer income that has a direct impact on rural poverty.

To clarify these kind of matters and given the various interpretations the term ‘CSR’ could be subjected to, it may be pertinent for the Ministry to consider establishing a dedicated cell for companies to advance-check whether their interpretation and undertaking of a particular project / activity would be aligned with the intent of the law. This will help in reducing retrospective action.

Also clarity needs to be provided in the definition of CSR policy about the meaning and intention of “activities in the normal course of business” say for example entities engaged in healthcare - whether eligible to do CSR if providing free or concessional treatment/ diagnostic services.

10. Board’s Authority

None can deny that community development is ingrained in the Indian social system and therefore CSR initiatives have been deeply embedded in the corporate culture from the very beginning. In view of some path-breaking initiatives undertaken by corporates across the spectrum - in rural development, in agriculture, in rehabilitation post-natural calamities, for poverty alleviation, skilling, education, etc - the Government should allow leeway to corporates to comply with the provision in a manner best suited to each one of them. This will help industry develop pioneering strategies and undertake meaningful CSR initiatives in a self-responsible manner.

CII has been suggesting that the power to decide CSR activities should be vested with the Boards. Such delegation of powers would be with the very premise of the Companies Act - self-governance and enhanced disclosures.

It is suggested that while considering various proposals that may come up before the Ministry for clarification, the scope of CSR be kept as wide as possible with scope for inclusion of additional intervention areas.

11. Misc clarifications / suggestions

- Clause 4 (5) programs should not benefit only employees – say for e.g a Hospital or school for the poor started under a CSR program?
- Schedule VII (i) talks of only PREVENTIVE health. Will this cover medical cure and hospitalization?
- Ref (iv) Green Building certification of IGBC/Leed entails a 360degree improvement on Air, water, energy etc. is this not under CSR?
- Ref (vi) Armed forces veterans recruited in companies for consultancy and on retainer ship – does it not come under this clause?
- Refn (x) –does participating and spending in the MRD’s PURA project come under this clause?
- If the basic product/service of the company is an enabler of social transformation/community good – how to distinguish between commercial and non-commercial benefit

- Guidance / Clarity on the concept of creating and owning shared values between company, developmental sector and community
- In the list of CSR activities provided in the rules (which also includes the schedule VII activities) is not completely inclusive of the social ecosystem. Whether or not social activities falling outside the purview of the schedule form a part of CSR activities requires clarity.
- The new law mentions a 'local area preference'. The Act provides that a company should give preference to the local area in which it operates for CSR spending. How would this work if a company has a pan India operation? Or selects a geography based on need? For instance, in cases of service industry which is spread across the nation, can the CSR spend be made in any one/more places of operation or should it cover all the locations?
- Valuation of in-kind investments by company – volunteering, pro bono advisory, skill development etc.
- Can products of the company if used for social good be considered CSR? Though it was earlier not allowed in the schedule, *a recent Delhi High Court ruling has allowed Pharma companies to report drugs distributed for free amongst those who are economically deprived to be reported as their CSR spend?* How does this work for other companies now?
- Need to put 'All aspects of Healthcare including curative healthcare facilities for the Poor' in Schedule VII.
- Need to bring more clarity on inclusion of salaries of CSR staff as part of CSR expenditure. Will employee volunteering during normal business hours be counted as CSR? Will staff salaries recruited solely for the purpose of CSR Management be included as CSR spend?
- Regarding contributions to the various funds, the current Schedule debar contribution to State Govt. Relief Funds and other disaster funds, which should have been included.
- Definition of Corporate Social Responsibility – donations should be considered inserted in Rule 2(c)(i) as: Projects, Programmes or Donations relating to activities specified in Schedule VII to the Act. Companies across India have been giving donations to various NGOs even when CSR was not mandatory. If such donations are not considered towards meeting CSR liability which is now mandatory @ 2% of profits, then such NGOs will find it difficult to continue their activities when donations are curtailed & at the same time the companies would find it difficult to continue with their commitment to support such NGOs
- The following items must be included under schedule VII
 1. Promoting and encouraging social business projects
 2. Under health inclusion of following activities
 - a. Provision of health care in the outreach areas,
 - b. Programme to eradication communicable diseases with an special focus on ATM(AIDS, Tuberculosis and Malaria)
 - c. Support to Cancer patient, Blindness eradication programme
- Under Rural Development inclusion of Building/improving Social infrastructure

Currently, there are no formal procedures or window available to the stakeholders to obtain clarity or guidance from the Ministry. Therefore, it is suggested that the Ministry should create a Cell and lay down formal procedures through which the stakeholders may approach the Ministry for seeking guidance on the issues regarding the implementation of the Act specifically, the matters relating to Interpretation of provisions of law.
