

Companies Act 2013

New Rules of the Game

October 2013

The top of the page features a photograph of a modern building with a glass facade. The KPMG logo is visible on the building. A dark blue horizontal band is overlaid on the bottom of the image, containing the title text in white.

MESSAGE FROM KPMG IN INDIA

The recently enacted Companies Act 2013 (the '2013 Act') is a landmark legislation and is likely to have far-reaching consequences on all companies operating in India. While a part of the 2013 Act has already become effective, the Draft Rules are in the midst of a consultation process.

This important legislation, that has been in the making for over 10 years, started off as an effort in 2004 by the then government to make changes in Indian corporate law in the context of the changing economic and business environment and to make Indian corporate environment more transparent, simple and globally acceptable.

Since then, as this legislation has taken final shape, it has been influenced significantly by other recent developments in the corporate sector, especially those where stakeholder interests seemed to be compromised. The erstwhile Companies Act 1956 (the '1956 Act'), which had been in existence for over fifty years, appeared to be somewhat ineffective at handling some of these present day challenges of a growing industry and the interests of an increasing class of sophisticated stakeholders.

Learning from these experiences, the 2013 Act promises to substantively 'raise the bar on governance' and in a comprehensive form purports to deal with relevant themes such as investor protection and fraud mitigation, inclusive agenda, auditor accountability, reporting framework, director responsibility and efficient restructuring.

To help decode the critical nuances and implications of the 2013 Act, we have analysed the key changes in this publication, and crystallised them into 6 critical themes – each aimed at a different stakeholder community, but all aimed at the one objective – 'Raising the Bar on Governance'. The level of change and the complexities associated with implementing the changes introduced by the 2013 Act are likely to be significant for companies, and the effects of these changes would be felt throughout their organisations. We are confident that this publication will help enhance debate on this important legislation, as the Indian corporate sector embarks on a new journey to implement the changes brought in by the 2013 Act.

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INTRODUCTION



The Companies Act, 2013 (the '2013 Act') received the assent of the President of India on 29 August 2013, and has now become law. The 2013 Act is the culmination of several years of effort to enact a new legislation governing companies to replace the Companies Act, 1956 (the '1956 Act').

The 2013 Act marks a major step forward and appreciates the current economic environment in which companies operate. It goes a long way in protecting the interests of shareholders and removes administrative burden in several areas. The 2013 Act is also more outward looking and in several areas attempts to align with international requirements.

There are many areas that are the subject to rules that are to be issued under the 2013 Act. The scale of change can be

assessed only once the Rules are finally issued and the devil might be in the detail.

These changes would need to be explained to analysts, investors and other stakeholders. Companies may have to contemplate major changes to data and systems, education and communication to stakeholders, and changes to corporate governance. Profit profiles may be impacted, and in many cases companies would need to ramp up resourcing in certain functions. It is imperative that companies start early in understanding the key implications of these changes and plan for the change.

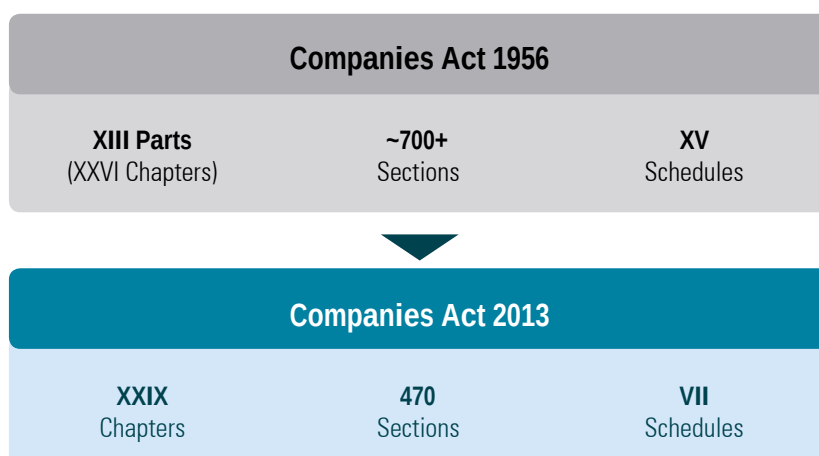
In this publication, we at KPMG in India have crystallised the key changes into the following 6 critical themes, each aimed at a different stakeholder community, but all aimed at the one objective – 'Raising the Bar on Governance'.

1. Increased Reporting Framework
2. Higher Auditor Accountability
3. Easier Restructuring
4. Wider Director and Management Responsibility
5. Inclusive CSR Agenda
6. Emphasis on Investor Protection

This whitepaper focuses on these 6 critical themes.

Key highlights and way forward

The 2013 Act is more concise as compared to the 1956 Act, with just 470 sections and 7 schedules. However, the key highlight of this 2013 Act is also the extent of subordinated legislation. There are over 300 references in the 2013 Act to Rules that may be prescribed to implement and operationalise those sections. Therefore, the full impact of the 2013 Act can only be understood when the related Rules get finalized and the two are read together.



Status of the 2013 Act

With a view to operationalising the 2013 Act, the Ministry of Corporate Affairs (the 'MCA') has already notified 98 sections effective 12 September 2013, with the corresponding sections in the 1956 Act being repealed. Therefore, the 2013 Act and the 1956 Act now co-exist with several situations where the two Acts will need to be read together and applied.

Way forward

Post finalization of Rules in the coming months, further sections of the 2013 Act are expected to be notified. We expect that the Act to be fully operational by 1 April 2014.

Status of Rules accompanying the 2013 Act

The MCA has also published for comments 25 chapters of draft Rules, in two phases. A third set of rules is expected to be published for comment shortly. Once the consultation process is completed, the MCA is expected to finalise these Rules and issue them in the coming months.

INCREASED REPORTING FRAMEWORK



- Mandatory requirement for consolidated financial statement (CFS) [section 129]
- New definition of subsidiary, associate, joint venture Company [sections 2(6) and 2(87)]
- Revision in financial statement [sections 130 and 131]
- Financial year to be uniform [section 2(41)]
- Changes in depreciation regulation [section 123(2) and Schedule II]
- Mandatory internal audit and reporting on internal financial controls [section 138]
- Other changes

In the 2013 Act, there is significant focus on corporate reporting framework, both internal and external and a wide range of changes have been introduced keeping in mind objectives, such as the need for relevance and consistency in the financial information being reported, alignment with international practices, greater focus on internal controls, etc. Some of the requirements have also been introduced to address lacunae in some of the provisions under the 1956 Act and curb any related abuse.

The key changes focused on the theme of increased reporting framework are discussed in the following paragraphs.

Mandatory requirement for Consolidated Financial Statement (CFS)

[section 129]

The 2013 Act mandates preparation of consolidated financial statements for all companies that have one or more subsidiaries. These would be in addition to the separate financial statements and are required to be prepared in the same form and manner as the separate financial statements. For the purpose of this requirement, the word subsidiary would include associate companies and joint ventures.

As per internationally accepted practices, consolidated financial statements are generally considered as the primary financial statements and the only general purpose financial statements, as standalone financial statements do not present a true picture from an economic entity perspective. The requirement of consolidated financial statements is therefore an important step even though the primacy of standalone financial statements has been maintained.

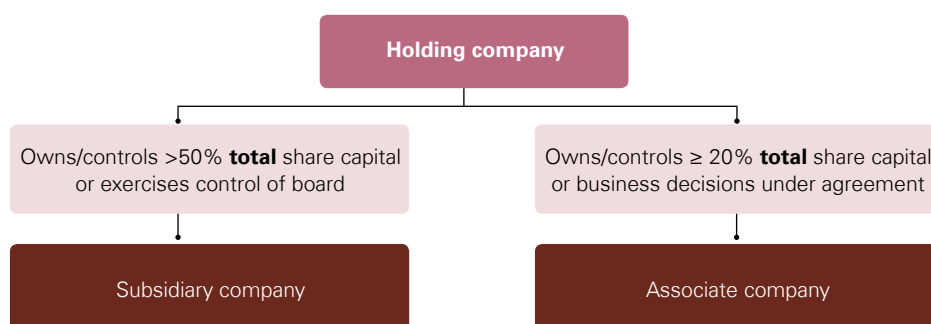
Currently preparation of consolidated financial statements is mandatory only for listed companies under the Securities and Exchange Board of India (SEBI) regulations. Preparation of consolidated financial statements now required under the 2013 Act would pose significant challenges for unlisted and private limited companies, who would be preparing consolidated financial statements for the first time. Further, there are no transitional provisions available to ease the process of consolidation, where groups have been existence for a long period of time.

Further, at present, preparation of consolidated financial statements is not mandatory for a listed company that has only an associate or a joint venture but not a subsidiary. Since the definition of a subsidiary under the 2013 Act includes an associate or joint venture, all companies including listed companies would need to prepare consolidated financial statements even if they have only an associate or a joint venture and not a subsidiary. The Companies would continue to follow the principles of AS 23 *Accounting for Investments in Associates in Consolidated Financial Statements* / AS 27 *Financial Reporting of Interests in Joint Ventures* for the purpose of accounting their investments in associates/ joint ventures respectively in the consolidated financial statements.

As per the 2013 Act, even intermediate holding companies within a group structure may need to prepare consolidated financial statements. Internationally, intermediate parents are generally exempt from preparing consolidated financial statements if certain conditions are met. This requirement would be onerous and might not add much value to the users of the financial statements.

New definition of Subsidiary, Associate, Joint Venture Company [sections 2(6) and 2(87)]

The definitions of the terms 'subsidiary' and 'associates' provided under the 2013 Act are inconsistent with the definitions provided under the accounting standards notified under the Accounting Standards Rules as analysed below:



Subsidiary

As per the 2013 Act, a 'subsidiary' is as an entity of which the holding company controls more than one-half of the total share capital (either directly or indirectly) or controls composition of the board of directors.

Control includes right to appoint majority of the directors (or to control the management or policy decisions, individually or in concert, directly or indirectly);

In contrast, AS 21 *Consolidated Financial Statements* defines a subsidiary as an enterprise that is controlled by another enterprise. Control is defined as the ownership, directly or indirectly through subsidiary (ies), of more than one-half of the voting power of an enterprise; and / or (b) control of the composition of the board of directors.

The definition of a subsidiary under the 2013 is based on ownership of the total share capital which includes preference share capital. This will have a significant impact on several companies which have issued preference shares. Also this definition does not consider the concept of control over voting power covered in AS 21.

Associate

The 2013 Act defines an 'associate' as a company in which that other company has a 'significant influence', but which is not a subsidiary company of the company having such influence and includes a joint venture company.

'Significant influence' means control of at least twenty percent of total share capital, or of business decisions under an agreement.

Under AS 23 *Accounting for Investments in Associates in Consolidated Financial Statements*, 'associate' is defined as an enterprise in which the investor has 'significant influence'. 'Significant influence' is defined as the power to participate in the financial and operating policy decisions of the investee but not control over those policies.

Similarly, the definition of an associate in the 2013 Act is based on control of business decisions as compared to the concept of power to participate under AS 23. The 2013 Act sets a threshold of 20 percent ownership of total share capital and hence does not consider influence over voting power, or any other manner in which significant influence may be established. AS 23 envisages situations in which significant influence may be demonstrated without meeting the 20 percent threshold which are not addressed in the 2013 Act.

An interesting feature of Schedule III (that provides general instructions for preparation of financial statements) is that it requires disclosure, for each joint venture, of amounts 'as per proportionate consolidation/investment as per the equity method', whereas AS 27 on *Accounting for Joint Ventures* does not permit accounting for jointly controlled entities as per equity method.

Revision in Financial Statement

[sections 130 and 131]

Under the 1956 Act, companies are generally not permitted to revise or restate financial information presented in their financial statements. Material misstatements in the accounts related to previous years, whether due to occurrence of fraud or error are reported as a 'prior period adjustment' in the financial statements of the year / period in which such misstatements are discovered.

The New Act introduces a new provision on re-opening/restatement of financial statements in the following circumstances:

- A statutory regulatory authority (e.g., Central Government, SEBI, income tax authorities, etc.) or any person concerned applies to the Tribunal or a court of law when the accounts of the company were prepared in a fraudulent manner or the affairs of the company were mismanaged thereby casting a doubt on reliability of the financial statements.
- Voluntary restatement on application by the Board of Directors if in their opinion the financial statements/ Board report do not comply with the requirements of the New Act, e.g., relating to compliance with accounting standards/form of financial statements, mandatory disclosures in the Board report, etc. Voluntary restatement is permitted after obtaining approval of the Tribunal in respect of three preceding financial years. Further, such restatement cannot be carried out more than once in a financial year.

While the voluntary revision to accounts is restricted only to the preceding three years, there is no time restriction to revision initiated by a statutory regulatory authority. The impact could be significant if the restatement is ordered of a period, many years into the past, as a restatement in one year will have a cascading effect on the following years.

In June 2012, SEBI had announced that it may require restatement of financial statements of listed companies, where the auditors had issued a qualified opinion. SEBI's announcement had set out a process relating to this, however, this requirement to restate was not consistent with the provisions of the 1956 Act. The New Act however, now provides an enabling legal framework for SEBI or any other regulatory authorities to apply for restatement of a company's financial statements.

The taxation implications of restatement will need to be evaluated by companies to understand the impact on Minimum Alternate Tax (MAT) liabilities as a result of change in the reported profits. In the event that restated financial statements are required to be audited and adopted by the members in a general meeting of the company, it is likely that the revised profit amount would be considered for MAT purposes. The Company would also need to consider whether it is required to / may voluntarily file a revised income tax return based on the restated accounts.

When a merger or other scheme of arrangement has been approved with retrospective effect by a court of law, it is unclear whether restatement of the previous year's financial statements will be required. Alternatively, the directors may be able to seek approval for voluntary restatement to give effect to the terms of the scheme in the financial statements of an earlier year.

The draft rules also state that when there is a change of auditors, the present auditor of the company has to report on the restated financial statements. This could prove to be burdensome on the Company and the auditor, as the entire financial statements would need to be subject to a reaudit. Additional guidance in the process to be followed by the present auditor could alleviate this issue.

Financial Year to be uniform

[section 2(41)]

The 2013 Act also requires all companies to adopt a uniform financial year of 1 April to 31 March with limited exception to a company which is a holding company or subsidiary of a company incorporated outside which may be required to follow a different financial year for consolidation outside India. All exceptions would however require the approval of the National Company Law Tribunal (the Tribunal). As part of transition provisions, Companies would be given a period of 2 years to change their accounting year to 1 April to 31 March.

Only holding or subsidiary companies of a company incorporated outside India would be entitled to the exception of having a different accounting year. However, these companies have to seek specific approval from the Tribunal to avail the exception which might be administratively burdensome. Further, it appears that associates / joint ventures are not covered under the exception.

Changes in Depreciation regulation

[section 123(2) and Schedule II]

Schedule II to the 2013 Act requires systematic allocation of the depreciable amount of an asset over its useful life unlike Schedule XIV of the Act (which specifies minimum rates of depreciation to be provided by a company). The depreciable amount is defined as the cost of an asset, or other amount substituted for cost, less its residual value. The residual value is generally not be more than 5 percent of the original cost of the asset.

The 2013 Act states that Schedule II will be applicable as follows:

- For a prescribed class of companies (whose financial statements are required to comply with accounting standards prescribed under the 2013 Act), the useful lives should normally be in accordance with the Schedule. However, if a prescribed company uses a different useful life, it should disclose a justification for doing so;
- For other companies, the useful life and the residual value applied should not be higher than that prescribed.

Prescribed companies are, however, permitted to use different useful lives than those specified in the Act and disclose their reasons for doing so. Accordingly, companies that have this flexibility and consider that their assets have longer useful lives, may not be adversely affected on transition.

Amortisation of intangible assets should be in accordance with notified accounting standards and is not specified in the 2013 Act.

Useful life

'Useful life' may be considered as a period over which an asset is available for use or as the number of production or similar units expected to be obtained from the asset by the entity. The useful lives specified in Schedule II of the 2013 Act for various assets will result in their depreciation over a different period than currently applicable under Schedule XIV of the Act. For example, for an entity using Straight line method of depreciation under the Act, useful life has been reduced for

- general plant and machinery from 21 years to 15 years;
- general furniture and fittings from 15 years to 10 year;
- computers from 6 years to 3 years;

Schedule II also specifies the useful life for depreciating additional types of plant and machinery used in various industries (e.g., exploration, power, metals, etc).

Component approach

Schedule II of the 2013 Act also states that the specified useful lives are for the whole of the asset. When the cost of a part (component) of the asset is significant to total cost of the asset and useful life of that part is different from the useful life of the remaining asset,

useful life of that significant part should be determined separately.

This indicates that companies are now required to adopt what is known as the 'component approach' to compute depreciation on fixed assets. A company will have to estimate the useful life of such a component (since it may not be provided in Schedule II) and depreciate the cost of that specific component over this estimated useful life.

The requirement to adopt a 'component approach' similar to that envisaged in Ind-AS, may be an onerous requirement for capital intensive companies since there will be significant effort involved in estimating useful lives for components. Further, for non-prescribed companies that cannot depreciate an asset over a useful life longer than that provided in Schedule II, it is unclear whether components may be depreciated for a longer period if the company estimates that the useful life is in fact longer. Further clarity would be required on this aspect for such companies.

Transition provisions

On transition, the carrying amount of an asset is depreciated as follows:

- Over the remaining useful life of the asset as per Schedule II of the 2013 Act; or
- Recognised in opening retained earnings when the remaining useful life of the asset is nil.



Mandatory Internal Audit and reporting on Internal Financial Controls

[sections 138]

Internal Audit

Class/classes of companies to be prescribed in this behalf to mandatorily appoint an internal auditor who shall be a chartered accountant or a cost accountant or such other professional as may be decided by the Board. Central Government may frame rules to prescribe the manner and intervals for conducting and reporting on internal audit. The objective of introduction of this requirement is to strengthen the system of internal controls in the wake of allegations of recent corporate frauds.

As per the draft rules, Internal Audit is now mandatory for (i) all listed companies; and (ii) other public limited companies with loans/deposits in excess of INR 25 crores or paid up capital in excess of INR 10 crores.

Internal financial controls reporting

The 2013 Act also requires the Directors Report for listed companies and Auditors Report for all companies to comment on whether the company has adequate internal financial controls system in place and operating effectiveness of such controls.

For this purpose, 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.

It may be noted that the provision covers all internal financial controls, including those relating to operational areas (unlike the Sarbanes Oxley Act, 2002 in the U.S. which limits the scope to internal controls over financial reporting). This would therefore cover an evaluation of the efficiency of operations of the Company. Although, the provisions would expand the scope

of audit but the new requirements could also result in more effective controls.

Other changes

- The concept of CFO has been recognised. The CFO would have rights and duties of a KMP. In addition, he would be liable, besides other specified persons, for contravention of provisions relating to maintenance of books of account, financial statements, filing of financial statements with Registrar of Companies, etc. The CFO would also be a 'related party' of the company. Statutory recognition of CFO is a significant step.
- Companies permitted to keep books of account or other relevant papers in electronic mode in the prescribed manner. The draft rules add that such electronic books shall remain accessible in India for future reference.
- Annual financial statements of every company (except one person company, small company or dormant company) to include a cash flow statement also.
- The existing regulatory regime governing transfer of a specified percentage of profits to reserves before declaring dividends dispensed with. However, declaration of dividends out of reserves to be subject to rules as may be prescribed. Companies will be allowed to declare dividends out of their current profits even when they have substantial accumulated losses of earlier years. Companies given more freedom regarding declaration of dividends. Interim dividend in a financial year not to exceed the average rate of dividend declared in the preceding three years if the company has incurred loss up to the end of the quarter immediately preceding the declaration of such dividend.

HIGHER AUDITOR ACCOUNTABILITY



- Auditor Appointment and Rotation [section 139]
- Auditor Reporting Responsibilities [section 143]
- Other changes

Auditor Appointment and Rotation

[section 139]

Term of appointment

As per the 2013 Act, instead of the present provision of appointment from one AGM to the next, individual or a firm to be appointed as auditor for a five-year term. Change of auditors before the five year term would require special resolution after obtaining the previous approval of the Central Government. Further the auditor concerned would have to be given a reasonable opportunity of being heard

However the appointment has to be ratified at every AGM. If the appointment is not ratified, it appears that the process for change of auditor would have to be followed.

Rotation of auditors

Listed companies or companies belonging to such class of companies as may be prescribed cannot appoint or reappoint an audit firm (including an LLP) as auditor for more than two consecutive terms of five years each (in case of an individual there would be one term of five years).

There is a cooling off period of five years for both individual auditors and audit firms. Audit firms having common partner or partners to the outgoing audit firm will also not be eligible for appointment till the cooling off period of the outgoing firm has expired.

Companies need to be compliant with the provisions relating to rotation within three years from the date of the commencement of the Act.

Central Government may, by rules, prescribe the manner of rotation. As per the draft rules, this requirement has been extended to all companies except small companies and one person companies.

Non-audit services

Prohibition on auditor rendering specified non-audit services to the auditee company/ its subsidiary/holding company e.g. accounting and book keeping services, internal audit, design and implementation of any financial information system, investment advisory services, investment banking services, management services etc.

Existing companies to get a transition period till the end of the financial year to comply with the new requirements.

Some believe that the scope of the term 'management services' must be clarified, else there would be confusion and consequent litigation on whether or not a service is permitted to be rendered by an auditor. Auditors have traditionally provided to their audit clients a range of non-audit services that are consistent with their skills and expertise. While some non – audit services may create threat to the independence of the auditor, the non-audit services in general may also benefit the Company. However, driven by the perceived independence threats, the list of prohibited services has been drastically extended.

The prohibition applies whether services are provided directly or indirectly, i.e. either by the audit firm or through its partners or through its parent or subsidiary or associate entity or through any other entity in which the firm or any partner has significant influence or control or whose name/trademark/ brand is used by the firm or its partners. Even the permitted services can be rendered only with the approval of the Board or Audit Committee.

Auditor Reporting Responsibilities

[section 143]

Auditors' report

The reporting requirements have been extended. Further, the Central Government, in consultation with National Financial Reporting Authority, may direct inclusion of specified matters for specified class/description of companies. As per the Act, the auditor has to report:

- Where the company has failed to provide any information and explanations, the details of the same and their effect on financial statements.
- Whether the company has adequate internal financial controls in place and the operating effectiveness of such controls.
- Observations or comments on financial transactions or matters which have any adverse effect on the functioning of the company.
- Any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith (this is in addition to the assertion relation to maintenance of proper books of account).
- Such other matters as may be prescribed.

The draft Rules require the auditor to comment on the disclosure by the company of effect of pending litigations on financial position, making of provision for foreseeable losses on long-term contracts including derivative contracts, and whether there has been any delay in making deposits in Investor Education and Protection Fund.

The scope of the expression 'financial transactions or matters' which have any 'adverse effect on the functioning of the company' is very wide. Unless the responsibilities are specifically defined, there would be so much ambiguity that the very purpose of the provision would be defeated. It would be appropriate if the scope of the expression 'financial transactions and matters' is limited to items having significant impact on financial statements.

The draft Rules add to the already onerous reporting requirements under the Act. The provision for foreseeable losses is required only in case of long term construction contracts under AS 7 and hence the word 'construction' should be added. The other two matters listed in the draft Rules are already examined and/or reported by the auditor as part of reporting on true and fair view/ CARO. Thus, the objective of inclusion of these reporting requirements is not clear.

Reporting on Fraud

If in the course of performance of his duties as auditor, the auditor has reason to believe that an offence involving certain fraud is being or has been committed against the company by officers or employees, the matter should be reported to the Central Government within the prescribed time and manner.

The relevant draft Rules state that the matter has to be reported immediately but not later than thirty days of his knowledge or information with a copy to the audit committee or in case the company has not constituted an audit committee, to the Board. As per the draft Rules the aforesaid reporting is required in case of (a) fraud(s) that is/ are happening frequently or (b) fraud(s) where amount involved or likely to be involved is not less than 5 percent of net profit or 2 percent of the turnover of the company for the preceding financial year.

In case of frauds other than the above, the draft Rules require the statutory auditor to report the matter to the Audit committee / Board of Directors.

Reporting on fraud to Central Government can be challenging, considering that the auditor is required to comment not only on confirmed frauds but also suspected frauds.

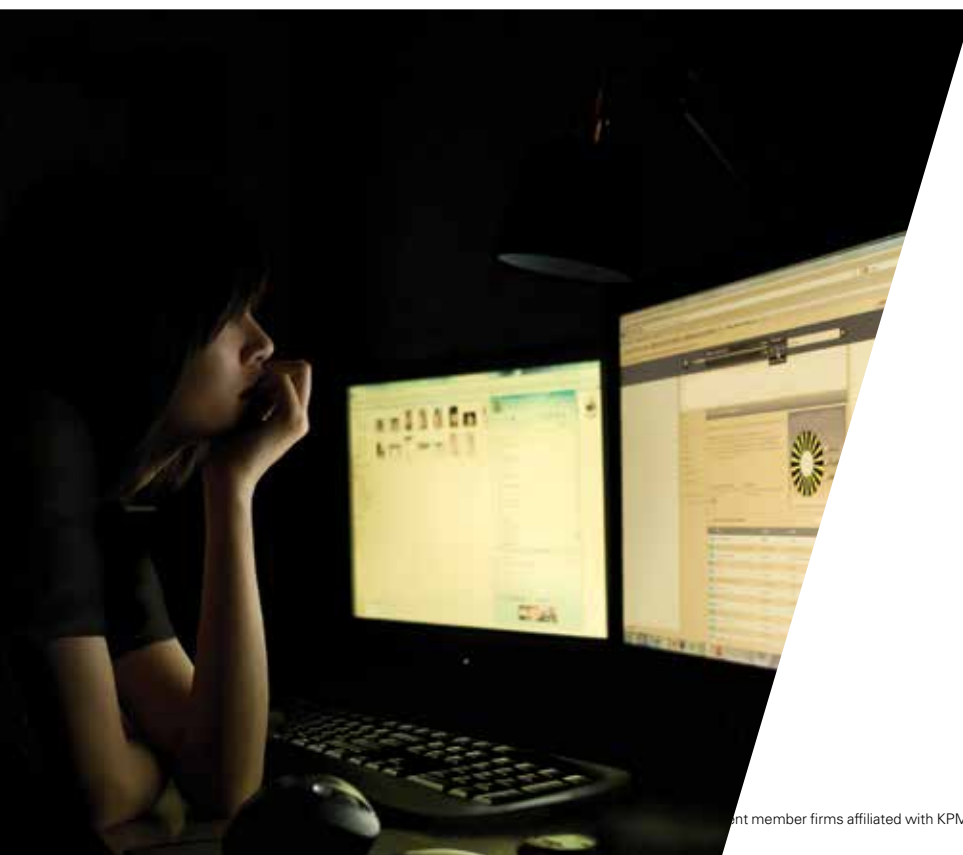
Other changes

Auditing standards

Recognition to auditing standards - Auditing standards have been given legal recognition under the Act which requires that every auditor shall comply with the auditing standards notified by Central Government. The Central Government may prescribe the standards of auditing as recommended by the Institute of Chartered Accountants of India (ICAI), in consultation with and after examination of the recommendations made by the National Financial Reporting Authority. Till the auditing standards are so notified, the standards on auditing specified by the ICAI will be considered as the prescribed standards.

National Financial Reporting Authority

An independent authority, viz. National Financial Reporting Authority (NFRA) to be constituted to make recommendations to Central Government on formulation and laying down of accounting and auditing policies and standards, monitor and enforce compliance therewith and oversee the quality of service of relevant professions. NFRA has been vested with quasi judicial powers to investigate matters of professional or other misconduct (as defined in CA Act) by chartered accountants 'for such class of bodies corporate or persons' as may be prescribed. At present matters relating to professional or other misconduct are handled by the Institute of Chartered Accountants of India. The new provisions would raise a number of practical issues apart from questioning the validity of the concept that a professional should be judged by his peers.



EASIER RESTRUCTURING



- Rationalizing Multilayered Structures [section 186]
- Simplifying Procedures for Restructuring [section 232]
- Registered Valuer [section 247]
- Minority buy-out [section 236]
- Cross-border Merger [section 234]
- Fast-track Merger [section 233]
- Other changes

Rationalizing Multilayered Structures

[section 186]

A company cannot, unless otherwise prescribed, make investment through more than 2 layers of investment companies except to comply with law and in case of acquisition of a foreign company. Compliance with this requirement may involve significant restructuring in many cases.

Government empowered to prescribe the maximum number of layers of subsidiaries that any class of holding companies can have. The objective seems to be to provide transparency about the real owners of the companies. However, this may impact many large Indian and foreign companies particularly companies operating in infrastructure sector in which land is held or separate funding of different projects is done through a chain of step down subsidiaries.

Simplifying Procedures for Restructuring

[section 230-232]

A serious effort made to address the shortcomings of the existing provisions and to provide for a simpler and faster process of mergers and acquisitions and other restructuring. In the 2013 Act, separate procedures prescribed for 'Compromise or Arrangement' and Amalgamation or Demerger'. The National Company Law Tribunal (NCLT) assumes jurisdiction of the High Court as sanctioning authority in relation to Restructuring.

The following are the key requirements for such restructuring transactions:

Compromise or Arrangement:

- Power of NCLT to dispense with the creditors meeting restricted.
- Auditor's certificate to the effect that the accounting treatment specified in the Scheme is in conformity with the prescribed Accounting Standard is required to be submitted to NCLT.
- Disclosures in and attachment with notice calling meeting substantially increased.
- Circulation of notice convening the meeting widened and requirement of issue of such notice to all concerned statutory and other authorities included.
- Voting allowed at the meeting as well as through postal ballot.
- Minimum shareholding / debt ownership limit provided for objecting to the Scheme.
- Sanction of buy-back, variation of rights etc. being part of the Scheme can be sanctioned only if in accordance with the provisions governing such processes.

Amalgamation/ Demerger:

- Treasury stock, holding the shares in the name of transferee company, prohibited.
- Yearly statement confirming implementation of the Scheme to be in accordance with the Order required to be submitted till completion of the Scheme.

In the absence of Transitional Provisions – No clarity with respect to Restructuring in process at the time of New Companies Act becoming operational.

To protect the interest of the members/ others affected by a scheme of compromise or arrangement, including a merger/amalgamation, valuation for this purpose to be carried out by a 'registered valuer'. Procedure for articulation of the minority's interest has also been streamlined while restricting the obstructionist attitude on the part of a section of minority.

All the above measures signify a recognition of the increasing significance of mergers and acquisitions in the new-look Indian economy.

Registered Valuer

[section 247]

Valuation in respect of any property, stocks, shares, debentures, securities, goodwill or any other assets or net worth of a company or its liabilities required under any provision of the Act shall be carried out by only a registered valuer. Valuers to be appointed by the Audit Committee or in its absence by the Board of Directors. Valuation issues are very contentious. Recognition of the concept of registered valuers and laying down their role and liabilities is therefore a significant step.

Minority buy-out

[section 236]

The New Act has introduced new provisions relating to Buy-back out of minority shareholding under certain circumstances. This will provide greater flexibility to the promoters/ acquirer in realigning the control and management of company as unnecessary interference from minority shareholders is removed.

The key provisions are:

- Any person or group of persons holding 90 percent or more of the issued equity capital of a company by virtue of an amalgamation, share exchange, conversion of securities or for any other reason, can purchase the remaining equity shares of the company from minority shareholders at a price determined by a registered valuer in accordance with prescribed rules.
- Provisions are applicable to acquirer and persons acting in concert as defined under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.
- The minority shareholders of the company may also offer to the majority shareholders to purchase the minority equity shareholding of the company at a price determined by a registered valuer in accordance with prescribed rules.
- It is provided that in case the majority shareholders acquiring > 75 percent of the minority shareholding had agreed to sell their shareholding at a price higher than the price offered to the minority shareholders then such majority shareholders need to share the additional compensation received by them with such minority shareholders on a pro rata basis. In view of the peculiar drafting, the real impact of the provision is unclear.
- It is provided that the above provisions would continue to apply to the residual minority equity shareholders, even though the shares of the company had been delisted and period of one year or the period specified by SEBI, had elapsed.
- This provision seems to be enabling provision to cover cases of listed company following delisting guideline and not succeeding to acquire entire minority shareholding.

Cross-border Merger

[section 234]

The existing Act allowed merger of a foreign company with an Indian company, but not vice versa.

The New Act provides for Amalgamation of/Demerger from a foreign company, whether having its place of business in India or not, with an Indian company and vice versa. The relevant requirements are as follow:

- Cross Border Mergers are allowed between a company under the New Act and a company incorporated in a notified jurisdiction.
- Central Government may make rules in connection with such Amalgamation.
- All the procedures for Restructuring discussed above will equally apply to Cross Border Merger.
- Prior approval of the Reserve Bank of India is necessary.
- The Scheme may provide for payment in cash or in Depository receipts or both.

Fast-track Merger

[section 233]

The New Act has also introduced a new concept of a Fast-track merger which, at the option of the companies involved, can be used for:

- The merger of two or more small companies, or
- The merger between holding company and its wholly owned subsidiary company, or
- Such other classes of companies as may be prescribed.

The principal benefits of the Fast-track merger over Amalgamation are:

- Approval of NCLT is not required
- As a consequence, the companies may not be required to file documents required to be filed under the listing agreement, in the case of listed companies
- Notice is not required to be given to various authorities.
- Shorter timeline.
- Auditor's certificate of compliance with applicable accounting standards is not required.

Issues in the Fast-track merger which may make it less attractive are:

- Central Government's power to transfer the Scheme to the NCLT for application of normal Amalgamation provisions.
- Positive confirmation required from 90 percent of shareholders and creditors holding 90 percent value.

Other changes

New types of companies permitted

One person company (OPC) which will be a separate and distinct entity from the promoter of the company.

Small company which would be a private company whose paid-up share capital does not exceed INR 0.5 crore or whose turnover does not exceed INR 2 crore. A holding or a subsidiary company cannot be a small company

Dormant company for a future project or to hold an asset or intellectual property and having no significant accounting transaction.

More choices and flexibility will be available. Companies that are economically less significant will have a simpler compliance regime. e.g. no requirement of annual general meeting (AGM) for OPC, relaxed provisions for meetings of the Board of Directors for OPC/Small company. Limit on the number of members in a partnership firm or association of persons increased from the present 20 to such number, not exceeding 100, as may be prescribed. The limit would not apply to a Hindu Undivided Family carrying on any business and to associations/partnerships formed by professionals governed by special Acts, such as chartered accountants. Larger partnerships would result in consolidation of talents and resources within this simpler form of business organisation.

WIDER DIRECTOR AND MANAGEMENT RESPONSIBILITY



- **Mandatory Director Appointment**
- **Additional Responsibility on Independent Directors [section 149]**
- **Audit Committee [section 177]**
- **Managerial Remuneration**
- **Key Managerial Personnel**

Mandatory Director Appointment

Maximum number of directors at 15 (12 at present). This number can be enhanced by special resolution without Central Government approval.

At least one director should be a person who has stayed in India for a total period of not less than 182 days in the previous calendar year. Certain class of companies to have at least one women director. The draft rules state that every listed company & other public company having either paid up share capital of more than 100 cr or turnover of more than 300 cr to appoint a women director.

For listed companies and other class of companies to be prescribed it would be mandatory to set up a Nomination and Remuneration Committee to recommend appointment and removal of directors/senior management and remuneration policy and to evaluate performance of directors. An attempt to enhance objectivity in these matters through non-executive and independent directors.

Companies having more than 1000 share holders, debenture holders, deposit-holders or other security holders at any time during the financial year to constitute a Stakeholders' Relationship Committee to resolve the grievances of security holders. An investor grievance redressal mechanism with a nonexecutive chairman would ensure protection of the interest of investors through timely intervention.

Apart from listed companies, other classes of companies as may be prescribed to have Audit Committee having a minimum of three directors with independent directors forming a majority; majority of members including its chairperson to be persons with ability to read and understand the financial statements.

The office of a director would become vacant if he remains absent for all meetings of the Board for a period of 12 months, even where the leave of absence has been obtained. This is likely to result in more active involvement of directors.

A director may resign his office by giving a notice in writing. However the resigning director would be liable for offences occurring during his tenure.

Disqualification of directors under the present section 274(1) (g) extended to companies other than public companies also.

Additional Responsibility on Independent Directors

[section 149]

Specific but inclusive duties of directors laid down; contraventions would attract punishment including compensatory fine. Apart from specific enunciation of good practices and concepts, this would result in easier prosecution of delinquent directors.

Central Government empowered to prescribe minimum number of independent directors for any class of unlisted public companies. Significance of independent directors in governance of large companies recognised.

Stricter eligibility criteria for independent directors e.g., should not be related to promoters or directors of the company or its holding, subsidiary, or associate company and should not have any pecuniary relationship with the company/its holding/ subsidiary / associate etc. during the specified period. This would ensure greater independence. The independent director needs to declare to the board that he is independent at the time of his appointment and also whenever there is a change that may impact his independence. Company and the independent directors should follow the code given in Schedule IV.

Tenure of independent directors limited to maximum of two consecutive tenures of five consecutive years with a cooling off period of three years thereafter; during cooling-off period, such a person cannot be inducted in any capacity in the company either directly or indirectly. For this purpose, tenure shall be computed prospectively from the commencement of the Act. Limited tenure will ensure fresh talent on the boards as well as reduce the

proximity of independent directors with management.

Independent director liable only for acts or omissions which occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently. Liabilities specified with defined limits

Not entitled to any remuneration, other than sitting fee and reimbursement of expenses and any profit related commission as approved by members; stock options prohibited. Separate limits may be laid down by government for sitting fee to independent directors.

Nominee directors are not considered independent directors. A small shareholder director providing declaration of independence is to be considered an independent director .

Audit Committee

[section 177]

Role of the Committee sharpened with specific responsibilities including recommending appointment of auditors and monitoring their independence and performance, approval of related party transactions, scrutiny of inter-corporate loans and investments, valuation of undertaking/assets etc. Audit committee is contemplated as a major vehicle for ensuring controls, sound financial reporting and overall good corporate governance.

All listed companies and public companies with paid-up capital of INR 100 crore or debt of INR 200 crore to have an Audit Committee.

Audit Committee should be constituted of:

- Minimum three directors
- Independent directors should be in majority. Also, majority of directors should have ability to read and understand financials
- Existing committees, if any, to transition and comply with above within one year
- Terms of reference to include certain processes, the significant being:
 - Approval of related party transactions and their modifications.
 - Scrutiny of inter-corporate loans and investments.
 - Evaluation of internal financial controls.
 - Monitoring of end use of proceeds of public offerings and related matters.

The Existing Act provided that the Audit Committee recommendation should be binding on the Board. Also the Chairman of the Committee was required to attend the general meeting. No such provisions are included in the New Act.

Managerial Remuneration

No change in overall/individual limits on managerial remuneration in public companies. Maximum limit of managerial remuneration retained at 11 percent (of net profits).

For public companies with no profits or inadequate profits remuneration payable in accordance with prescribed Schedule V wherein limits generally enhanced compared to present position; certain additional exemptions for companies where remuneration is paid by another company, for newly incorporated companies, for sick companies and SEZ companies.

All public companies would have to seek approval of Central Government if the limits of Schedule V are exceeded. The new provisions are somewhat more stringent than the present position where Government approval for payment beyond the limit is not required in the case of an unlisted public company unless such a company is a subsidiary of a listed company.

Key Managerial Personnel

Emphasis on the role and responsibilities of key management of companies. It will be mandatory for classes of companies, as prescribed by the Central Government, to appoint wholetime key managerial personnel (KMP) by means of a Board resolution.

'Key managerial personnel' defined to mean Managing Director (MD) or Chief Executive Officer (CEO) or Manager, whole-time director(s) (if any), Company Secretary, and Chief Financial Officer (CFO). KMPs are covered as 'officer who is in default' and hence would be liable in that position also. KMPs are also included in 'related parties' of a company. The draft rules state that a director or KMP of the holding subsidiary or associate co. or his relative are also Related Parties. Further any person in senior management in co; holding subsidiary or associate co. are also KMP

Senior management comprise of personnel who are members of core management team comprising members of management one level below the executive directors, including functional heads.

Recognition of highest management level personnel with liabilities commensurate with their position. Restrictions on forward dealing/insider trading by directors/ KMP. No director/ KMP can be involved in forward dealing or buying options in shares/debentures of company or its holding/ subsidiary/ associate company.

No person (including director/ KMP) shall enter into insider trading. Stringent punishment for non-compliance. While punishment for insider-trading is welcome, some experts feel that forward dealing or buying options should be permitted within defined and prudent limits.

INCLUSIVE CSR AGENDA



- Applicability
- Appointment of CSR committee
- Responsibility of the Board
- What constitutes eligible CSR spend

Applicability

As per Section 135 of the Act, companies with a specified net worth or turnover or net profit are required to mandatorily spend 2 percent of its average net profit towards specified CSR activities.

- Every company having net worth of INR 500 crore or more, or turnover of INR 1000 crore or more or net profit of INR 5 crore or more during any financial year will have to comply with the CSR provisions as laid down under the Act.
- If any of the above financial strength criteria is met, the qualifying company is mandatorily required to spend at least 2 percent of the average net profit¹ of past three financial years on specified CSR activities.

- While the threshold limit of net worth criteria and the turnover criteria are kept higher, the net profit threshold limit of mere INR 5 crore will bring majority of companies under the CSR net.

Under the draft CSR rules, net profit is defined to mean 'net profit before tax' as per books of accounts and shall not include profits arising from branches outside India.

Appointment of CSR committee

Every qualifying company needs to constitute a CSR committee of the Board consisting of 3 or more directors.

Though the CSR provisions under the Act required minimum 3 directors for constitution of CSR committee, the issue that needs to be clarified is whether qualifying private companies (which requires minimum two directors only) would be required to appoint one more director only to constitute CSR committee and comply with the CSR provisions.

The mandate of the said CSR committee shall be:

- To formulate and recommend a CSR policy to the Board;
- To recommend amount of expenditure to be incurred on CSR activities;
- To monitor the CSR policy of the company from time to time.

In this context, the draft CSR rules specifies that following should be included in CSR policy:

- Details regarding list of projects / programs to be undertaken, modalities of execution, areas / sector chosen, implementation schedules, etc;
- That the surplus arising out of the CSR activity will not be part of business profits of a company;
- That corpus to include the following:
 - 2 percent of average net profits;
 - Any income arising therefrom
 - Surplus arising out of CSR activities.

Responsibility of the Board

The Board of every qualifying company is required to hold following responsibilities:

- To approve the CSR policy recommended by the CSR committee and disclose the contents of such policy in its report and place it on company's website;
- To ensure the CSR activities are undertaken by the company;
- To ensure 2 percent spending on CSR activities;

- To report CSR activities in Board's report and disclose non-compliance (if any) with the CSR provisions.
- The draft CSR rules provide the format in which all qualifying companies shall report the details of their CSR initiatives in the Director's report and in the company's website.

What constitutes eligible CSR spend

Activities which may be considered as eligible CSR spend are provided in Schedule VII of the Act. The specified activities are as under:

- Environment sustainability
- Empowering women and promoting gender equality
- Education
- Poverty reduction and eradicating hunger
- Social business projects
- Reducing child mortality & improving maternal health
- Improvement of health
- Imparting of vocational skills
- Contribution towards Central & State Government funds for socio-economic development and relief
- Such other matters as may be prescribed

The companies shall give preference to the local area and area around it where it operates for spending the amounts earmarked for CSR activities.

The draft CSR rules further provide following guidelines / manner in which the company can undertake CSR activities and incur CSR spend:

- The company can set-up a not-for-profit organisation in the form of trust, society or non-profit company to facilitate implementation of its CSR activities. However, the contributing company shall specify projects / programs to be undertaken by such an organisation and the company shall establish a monitoring mechanism to ensure that the allocation to such organisation is spent for intended purpose only.
- A company may also implement its CSR programs through not-for-profit organisations that are not set up by the company itself.
- Such spends may be included as part of company's prescribed CSR spend

only if such organisations have an established track record of at least 3 years in carrying on activities in related areas.

- Companies may also collaborate or pool resources with other companies to undertake CSR activities.
- Only CSR activities undertaken in India would be considered as eligible CSR activities.
- CSR activities may generally be conducted as projects or programmes (either new or ongoing), however, excluding activities undertaken in pursuance of the normal course of business of a company.
- CSR projects / programs may also focus on integrating business models with social and environmental priorities and processes in order to create shared value.
- CSR activities shall not include activities exclusively for the benefit of employees and their family members.

In this context, some of the issues still not clarified / need further clarity are as under:

- The concepts of 'business process integration' and 'shared value' are not defined in the Act / draft CSR rules.
- While the draft CSR rules specify that CSR activities shall not be exclusively for the benefit of employees / their families, it does not provide any objective criteria of certain benefits (not exclusive) given to employees / their families that could be regarded as CSR activities.
- Whether the list of activities specified under Schedule VII of the Act is exhaustive?
- While the draft CSR rules suggest that tax treatment of CSR spend will be in accordance with the Income-tax Act, 1961 as may be notified by Central Board of Direct Taxes (CBDT), one will have to wait and watch for notification from CBDT and whether the same provides adequate certainty on tax treatment of CSR spend.

EMPHASIS ON INVESTOR PROTECTION



- Related Party Transactions [section 188]
- Investments/Loans
- Oppression and Mismanagement [section 241-246]
- Fraud Risk Mitigation
- Other Investor protection measures

Related Party Transactions

[section 188]

The Companies Act, 2013 has made significant amendments vis-à-vis related party transactions making this a significant focus area. The responsibilities are rather onerous with strict consequences in cases of non-compliance. Key highlights are as follows:

The transactions of a company with its related parties which are not in the ordinary course of business and which are not arm's length would require the consent of the Board of Directors of the Company.

Related party transactions have been defined to include the following:

- Sale, purchase or supply of any goods or materials
- Selling or otherwise disposing of, or buying, property of any kind
- Leasing of property of any kind
- Availing or rendering of any services

- Appointment of any agents for purchase or sale of goods, materials, services or property
- Related party's appointment to any office or place of profit in the company, its subsidiary company or associate company and
- Underwriting the subscription of any securities or derivatives of the company.

The definition of 'related party' with respect to a company has been widely defined and includes:

- Holding Company,
- Subsidiary Company,
- Sister Subsidiary,
- Associate Company,
- Directors, Key Management Personnel (including relatives),
- Firms / companies where directors / relatives are interested and
- Senior management i.e. members of core management team one level below executive directors including functional heads.

Senior management / functional heads have been included in the draft rules even though they may not be in a position to control or take key decisions of the Company. Further 'relatives' in relation to an individual covers several generations without distinguishing between dependant and non-dependant relatives.

- Prior shareholders approval by special resolution would be required in respect of related party transaction exceeding the following prescribed limits:
 - Paid up share capital of the Company equals or exceeds INR 1 crore; or
 - Related party transactions exceeding following threshold limits:

Nature of related party transaction	Threshold Limits
• Sale / purchase of goods, • Availing or rendering of services, • Buying / selling / leasing of property and • Appointment of agent for purchase or sale of goods, materials, services or property	Aggregate / individual transactions > 5% of annual turnover or 20% net worth, per last audited accounts (whichever is higher)
Appointment to any office or place of profit in company, subsidiary or associate	Monthly remuneration exceeding INR 1 lac
Remuneration for underwriting subscription of any securities or derivatives	Remuneration exceeding INR 10 lacs

No member shall vote on the special resolution if such member is a related party. However, an exception has been made in the case of wholly owned subsidiary ('WOS'), where a special resolution passed by the holding company would be considered sufficient for entering into transactions between holding company and WOS. However it would be pertinent to note that a similar clarification has not been given in case of transactions with Sister Subsidiaries, Associated Companies and Joint Ventures.

The directors report would include details of related party transactions requiring consent of the Board/special resolution of members along with the justification for entering into them.

Central Government approval would no longer be required for appointment of any director or any other related person to any office or place of profit in the company or its subsidiary. In the case of transactions of a company with related parties, the existing government approval-based regime has been replaced by the shareholder approval and disclosure-based regime.

There are significant penal consequences in case the consent of Board of Directors / Special Resolution has not been obtained:

- Contract may be rendered as void
- Directors concerned to indemnify the loss
- Director / employee involved can be fined and imprisoned (in case of a listed company)

'Arms length transaction' has been defined to mean a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.

However it would be pertinent to note that methodologies and approaches for determining the arm's length transactions have not been prescribed in the 2013 Act.

Whilst the 2013 Act and the accompanying draft Rules do not provide guidance on the methodologies / approaches for determination / demonstration of the arm's length nature of related party transaction, such methodologies / approaches do exist under the Indian transfer pricing guidelines contained in the Income Tax Act, 1961. One would adopt such methodologies / approaches for the Companies Act purposes as well in absence of any specific guidance under the 2013 Act.

As discussed above, the concept of related party transactions and determination of arm's length price vis-à-vis such transactions exist under the Income Tax Act, 1961. However an analysis of such related party transaction for Income-tax purposes may not suffice the obligations cast under the Companies Act due to several differences between the provisions of Income-tax law and the Companies Act as summarized below:

Transactions	Income Tax Act	Companies Act
International transactions	• Shareholding trigger of 26% for constitution of related party • Only equity stake considered for computing the 26% threshold	• Shareholding trigger of 20% for constitution of related party • Equity and preference stake to be considered for computing the 20% threshold
Domestic transactions	• Related parties include: – Direct Holding company – Direct subsidiary – Sister subsidiary – i.e. a company where there is a common direct parent • Applies only to the expense side of the transaction (except tax holiday units) • Only equity stake considered for computing the 20% threshold.	• Related parties include holding companies, subsidiaries, associates, JVs etc taking into consideration direct + indirect holdings • Equity and preference stake to be considered for computing the 20% threshold • Covers expenses and income vis-à-vis related party dealings.

Investments/Loans

Provisions relating to caps on inter corporate loans and investments extended to include loan to any person..

The rate of interest on inter corporate loans not to be lower than the prevailing yield of one year, three year, five year or ten year Government security closest to the tenor of the loan.

Loans (as also guarantees/securities in respect thereof) and investments by a private company or by a holding company to or in its wholly owned subsidiary would also be covered by the provisions.

Oppression and Mismanagement

[section 241-246]

The concept of class action suits introduced empowering a specified number of shareholders and depositors to take legal action in case of any fraudulent action by the company or if the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors. Class actions suits have been prevalent in US, Australia and some EU countries. The provision is a significant step towards protecting shareholders and depositors.

Fraud Risk Mitigation

Specific definition of fraud has been introduced

Fraud includes any act, omission, concealment of any fact or abuse of position committed by any person, with intent to deceive, **to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person**, whether or not there is any wrongful gain or wrongful loss.

Increased responsibility on the directors and management

Detailed information about the subscribers to the memorandum and the first directors is required to be given to the Registrar at the time of incorporation of a company, along with an affidavit from each of them confirming that it he is not convicted of specified offences and has not been found guilty of any fraud or misfeasance etc. during the last five years.

Companies are also required to establish a vigil mechanism for directors and employees to report genuine concerns, even directly to the chairperson of the Audit Committee for appropriate cases. The mechanism should provide for adequate safeguards against victimisation of persons who use such mechanism. Importantly, the details of such mechanism are required to be disclosed by the company on its website and in the Board's report.

The Directors Responsibility Statement is required to include a confirmation regarding proper and sufficient care for the maintenance of adequate accounting records for safeguarding

the assets of the company and for preventing and detecting fraud and other irregularities. Establishing a fraud risk management procedures would thus be of importance for preventing fraudulent situations and enabling timely and due monitoring and oversight by the directors.

Auditor responsibility

Auditor of the company has been given responsibility to report an offence involving fraud to the Central Government.

Investigation into the affairs of the Company

An investigation into the affairs of the Company can be initiated by the Central Government in the following circumstances:

- on receipt of report from the Registrar of Companies,
- on intimation of a special resolution passed by the company
- in public interest
- on receipt of an order of court or tribunal
- on request of any department of central government or state government.

The investigation into the affairs of the Company can be in the hands of inspectors as appointed by Central Government or by assignment of the case to Serious Fraud Investigation Office (SFIO).

Statutory status is given to SFIO established under Ministry of Corporate Affairs. SFIO will comprise experts from various relevant disciplines including law, banking, corporate affairs, taxation, capital market, information technology and forensic audit.

Investigation report of SFIO filed with the Court for framing of charges shall be treated as a report filed by a Police Officer. SFIO shall have power to arrest in respect of certain offences which attract the punishment for fraud. Recognition of SFIO would strengthen and expedite the investigation process. The legal and statutory powers vested with the SFIO and its broad-based composition with experts drawn from various relevant disciplines would make the process more effective.

The Act specifies that, as part of an investigation, in case the persons concerned in formation of the company or management of its affairs are found to be guilty of fraud, then the person in default shall be punishable for fraud. In light of the above, the companies will have to make sure they have adequate processes, controls and oversight mechanisms to ensure that the affairs of the Company are in order and in compliance with the requirements of the Act.

Investigation in the matters relating to fraud can be ordered even during winding-up of the company and removal of liquidator in case of lack of independence or conflict of interest. Further, the ongoing investigation need not be suspended on account of commencement of winding-up proceedings. Joint and several liability of the persons in charge of management if the company makes an application for removal of its name with an intent to commit fraud.

Penalties for fraud

The offences of fraud are non cognizable and the person accused of such offense cannot be released on bail, unless for exceptions as provided. Person found to be guilty of fraud shall be punishable with imprisonment not be less than six months, which may extend to ten years. The person shall also be liable to fine upto a maximum of three times the amount involved in the fraud.

Other Investor protection measures

Amongst other uses, Investor Education and Protection Fund (IEPF) can be utilised to distribute, in accordance with court orders, disgorged amount among investors who have suffered losses. Besides unpaid or unclaimed dividend (for 7 years) corresponding shares to be also transferred to IEPF. Unlike as at present, claim of an investor over an unclaimed dividend or other amount transferred to IEPF shall not be extinguished. This may cause undue hardship where only a small dividend remains unclaimed.

Companies will be allowed to accept (or renew) deposits only from members, that too after obtaining shareholders' approval and compliance with certain conditions, except that public companies meeting minimum net worth or turnover thresholds as may be prescribed would also be allowed to accept deposits from public on complying with certain conditions including credit rating. Restrictions on acceptance of deposits does not apply to

- banking and non-banking financial companies,
- such other companies as may be specified by the Central Government in consultation with RBI

Source of promoters' contribution is required to be disclosed in prospectus. To ensure a trail of ownership, a listed company will be required to file a return with the registrar for change in shares held by promoters/ top ten shareholders' within 15 days of such change.

Except in the case of a rights issue or issue to employees through employees' stock option or issue of shares by a company upon exercise of conversion option attached to debentures/loans, any further issue of shares would have to be made at a price determined by a Registered Valuer and be subject to such conditions as may be prescribed. The objective is to ensure that pricing of preferential and similar issues is fair.

There are a number of other measures discussed in other parts of this note which also have investor protection as their major objective.



IMPACT ON VARIOUS STAKEHOLDERS



Board of Directors

- Accountability to stakeholders beyond only shareholders
- Reporting beyond SOX
- Liability on Class Action Suits
- Significant penalties on Insider Trading and restatements
- Societal scrutiny on CSR
- Compliance on Related Party Transactions
- Roll-out of whistle-blower vigil mechanism
- Mandate on gender diversity.

Audit Committee

- Additional rigor on financial reporting
- Mandatory internal audit
- Reporting beyond SOX
- Significant penalties on Insider Trading and restatements
- Compliance on Related Party Transactions
- Monitoring inter-corporate loans and investments.
- Evaluation of internal financial controls.

CXO and Key Management Personnel

- Ease of restructuring
- Reporting beyond SOX
- Wider definition of Related Party Transactions
- New depreciation rules may affect profitability
- Liable for Class Action Suits
- Significant penalties on insider trading and restatements.

Independent Directors

- Oversee implementation of best corporate governance practices.
- Safeguard interests of all stakeholders
- Ensure adequate and functional vigil mechanism.
- Determine appropriate levels of remuneration for Directors and KMP.
- Compliance on Related Party Transactions
- Prime accountability on CSR compliance
- Liability on Class Action Suits

Promoters

- Multi-layered structures to be collapsed
- Cross-border transactions allowed
- Mandatory CSR contribution will affect cash flows
- Wider definition of Related Party Transactions
- Heavy penalties introduced on Insider Trading
- Lower consolidation threshold may invite greater scrutiny [PE Firms to be hit]
- New depreciation rules may affect profitability

Multi National Corporation

- Lower thresholds for financial consolidation
- Mandatory contribution to local CSR
- Wider definition of Related Party Transactions
- Ease in cross-border restructuring
- Facility of minority buy-out
- Liable for Class Action Suits
- Board meetings through video conference
- Compliance on Related Party Transactions
- One Resident Director mandatory.
- Additional reporting responsibilities in Board's Report.

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