
COMPANIES ACT, 2013: AN ANALYSIS OF KEY RULES

Article Particulars

Received: 03.02.2018

Accepted: 15.03.2018

Published: 28.04.2018

A.KUMAR

Assistant Professor of Commerce, SNMV College, Coimbatore, Tamil Nadu, India

Abstract

The Companies Act, 2013 is landmark legislation with far reaching consequences on all companies incorporated in India. The Act, 2013 is more outward looking and attempts to align with international requirements. It is expected to set the tone for a more modern legislation which enables growth and greater regulation of the corporate sector in India. The 2013 Act has been developed with a view to enhance self-regulation, improve corporate governance norms, enhance accountability on the part of corporates and auditors, raise levels of transparency and protect interests of investors, particularly small investors. This paper is focused on the provisions of Companies Act, 2013 & analysis of the key changes.

JEL Classification: K22: Corporation and Securities Law

Keywords: Companies Act, 2013; Corporate Social Responsibility; Central Government

Introduction

The long awaited Companies Bill, 2012 was passed by the Lok Sabha on 18th December, 2012 and by the Rajya Sabha on 8th August, 2013. On receiving the assent of the Hon'ble President of India on August 29, 2013, it was notified on August 30, 2013 as the Companies Act, 2013. The Companies Act, 2013 has replaced the existing 56 year old company law, i.e. Companies Act, 1956. The Act has become fully operational since 1 April, 2014. It moves from the regime of control to that of liberalisation or self-regulation. The Act, 2013 provides for business friendly corporate regulation, egovernance initiatives, good corporate governance, Corporate Social Responsibility, enhanced disclosure norms, enhanced accountability of management, audit accountability, protection for minority shareholders, investor protection and activism and better framework for insolvency regulation and institutional structure.

Objectives of the Study

The study has been geared towards achieving the following objectives:

1. To examine Key Rules under Companies Act, 2013;
2. To understand the implications of Companies Act, 2013;

3. To disseminate information about the latest happenings in the Company Law field to people engaged in policymaking, policy analysis, policy research and other Stakeholders;
4. To provide information for future research works on Companies Act, 2013.

Research Methodology

The research paper is an attempt of exploratory research, based on the secondary data sourced from journals, magazines, articles and media reports.

Available online on www.saiompublications.com 15

Looking into requirements of the objectives of the study the research design employed for the study is of descriptive type. Keeping in view of the set objectives, this research design was adopted to have greater accuracy and in depth analysis of the research study.

Available secondary data was extensively used for the study. The investigator procures the required data through secondary survey method. Different news articles, Books and Web were used which were enumerated and recorded.

The Companies Act, 2013: Key Rules

The Companies Act, 2013 introduces significant changes in the provisions related to governance, management, compliance and enforcement, disclosure norms, auditors and mergers and acquisitions. The key highlights of the 2013 Act are summarized below:

The Journey of Companies Act, 2013

2008: Companies Bill, 2008 was introduced on 23rd October 2008 in the Lok Sabha to replace existing Companies Act 1956.

2009: Companies Bill, 2009 was re introduced on 3rd August 2009 in the Lok Sabha. Bill was referred to the Standing Committee on Finance of the Parliament for examination and report.

2010: Report of the Standing Committee on Finance on Companies Bill, 2009 was introduced in the Lok Sabha on 31st August 2010.

2011: Companies Bill 2011 introduced in the Lok Sabha on 14th December 2011.

2012: The Companies Bill, 2012 was introduced and got its assent in the Lok Sabha on 18 December 2012.

2013: Companies Bill, 2012 was passed by the Rajya Sabha on 8th August, 2013. After having received the assent of the President of India on 29 August 2013, it has now become the much awaited Companies Act, 2013.¹

Board Framework

The Companies Act, 2013 states that:

- Company can have a maximum of fifteen directors on the Board. Approval of shareholders through a special resolution in the General Meeting shall be required for appointing more than fifteen directors.
- 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
- The Act, 2013 makes it mandatory for a certain class of companies to appoint at least one woman director.
- A person cannot become a director in more than 20 companies instead of 15 as provided in the Companies Act 1956 and out of this 20, he cannot be director of more than 10 public companies.

Independent Directors

The term Independent Director has now been defined in the 2013 Act, along with several new requirements relating to their appointment, role and responsibilities. The Concept of independent directors has been introduced for the first time in order to add transparency, fairness and independence in decision making to safeguard stakeholders' interest. The Act states that:²

- At least one-third of the total number of director of a listed public company should be independent directors;
- Every independent director should at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the circumstances which may affect his status as an independent director, give a declaration that he meets the criteria of independence;
- Selection of independent director from a data bank maintained by an association, body or institute or as per the specification of the Central government; and
- An independent director shall not be entitled to any stock option or any remuneration other than sitting fee, reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members.
- An independent director and a non-executive director not being promoter will be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through board processes, with his consent or connivance or where he had not acted diligently.

Committees of Board

Audit committee

The Companies Act, 2013 makes audit committees mandatory for listed companies and other prescribed classes of companies. The Audit committee shall consist of a minimum of three directors with independent directors forming a majority and majority

of members including its Chairperson shall be persons with ability to read and understand the financial statement.

Nomination and Remuneration Committee

The constitution of Nomination and Remuneration Committee has also been made mandatory in the case of listed companies and such other class or classes of companies as may be prescribed. The Committee shall consist of three or more non executive directors out of which not less than one half shall be independent directors. This committee shall amongst other:

- Identify persons who are qualified to be directors and who can be appointed in senior management;
- Recommend to Board of directors, policy relating to remuneration to directors, Key Managerial Persons and other employees keeping in mind appropriate performance bench mark; striking a balance between fixed and incentive pay etc.; and
- Be responsible for evaluation of every director of Board consisting of three or more directors.

Corporate Social Responsibility (CSR) Committee

The Act provides that a company meeting certain conditions should constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director. The functions 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 as specified in Schedule VII; and
- To monitor the CSR policy of the company from time to time.

Stakeholders Relationship Committee

The Act requires that Companies with more than 1000 shareholders, debenture-holders and any other security holders at any time during a financial year to constitute a Stakeholders Relationship Committee. The committee shall consist of a non-executive director as a chairperson. The committee will consider and resolve the grievances of security holders of the company.

Source: http://gtw3.grantthornton.in/assets/Companies_Act-Governance.pdf

Audit and Auditors

Internal Audit

Under the Companies Act, 2013 following class of companies will be required to mandatorily appoint an internal auditor for internal auditing, on the functions and activities of the company:

- Every listed company;
- Every public company having paid-up share capital of more than Rs 10 crore;
- Every other public company which has any outstanding loans or borrowings from banks or public financial institutions more than Rs 25 crore or which has accepted deposits of more than Rs 25 crore at any point of time during the last financial year.

The board shall either appoint chartered accountant or cost accountant or any other professional for carrying internal audit. The objective of introduction of this requirement is to strengthen the system of internal controls. The Central Government may, by rules, prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board. ³

Appointment of auditors

Under the Companies Act, 2013 the first auditor will be appointed by the Board of directors within 30 days of incorporation of a company. The members shall appoint the first auditor within 90 days at the extra ordinary General Meeting, if the first auditor is not appointed by the Board within 30 days from the date of incorporation. A company will appoint Subsequent auditor at its first Annual General meeting and the auditor appointed will hold its office till the conclusion of the sixth Annual General meeting. The members at every subsequent Annual General meeting will be required to ratify the appointment of auditor, in case a fresh appointment is not made.

Rotation of auditors

The 2013 Act now mandates the rotation of auditors after the specified time period to ensure independence of Auditor and strengthen diligence in their role and conduct. No listed company or a company belonging to a certain class or classes of companies as may be prescribed should appoint or reappoint an auditor for:

- More than one term of five consecutive years if the auditor is an individual; and
More than two terms of five consecutive years, if the auditor is an audit firm.

Corporate Social Responsibility

Section 135 of the 2013 Act, makes an effort to introduce the corporate social responsibility in Indian corporates by requiring companies to formulate a corporate social responsibility policy and at least incur a given minimum expenditure on social activities. It will add sense of responsibility and contribution among corporates. The requirement will apply to any company that is incorporated in India, whether it is domestic or a subsidiary of a foreign company. Companies are subject to the CSR requirements if they have, for any financial year:

- Net worth of at least Rs. 5 billion (approximately U.S.\$80 million);
- Turnover of at least Rs. 10 billion (approximately U.S.\$160 million); or
- Net profits of at least Rs. 50 million (approximately U.S. \$800,000) during any of the previous three financial years.

Companies meeting these criteria are required to ensure that the company spends in every financial year at least 2% of the average net profits of the company made during the three immediately preceding financial years, if the company fails to spend such amount, the Board shall in its report specify the reasons for not spending the amount. The approach is to 'comply or explain'. The board will approve the CSR policy and disclose its contents in the board report and place it on the company's website.⁴ It is estimated that a total of 8,000 companies in India would be required to meet the CSR requirements among the 9 lakh active companies in India and the 2% CSR expenditure would translate to companies' spending around Rs 12,000 crore to 15,000 crore annually.⁵

Disclosures

Annual return

Every company shall prepare the annual return in the prescribed form containing the particulars as they stood on the close of the financial year. The information that needs to be included in the annual return has been increased. The additional information required, includes particulars of holding, subsidiary and associate companies, remuneration of directors and key managerial personnel, penalty or punishment imposed on the company, its directors or officers.

Board's report

Section 134 of the Act seeks to make the board's report more comprehensive by inserting disclosures to bring transparency in the functioning of the Board. Important disclosures include:

- extract of annual return in the prescribed form;
- company's policy on director's appointment and remuneration including the criteria for determining qualifications, positive attributes, independence of a director etc. ;
- a statement of declaration by independent directors;
- explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report and by the company secretary in practice in his secretarial audit report;
- particulars of loans, guarantees, or investments made;
- particulars of contracts or arrangements entered into;
- conservation of energy, technology absorption, foreign exchange earnings and outgo in the prescribed manner;
- Statement indicating development and implementation of a risk management policy for the company; and
- Corporate social responsibility initiatives taken during the year in case of listed companies and other prescribed class of companies.

Source: <http://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf>, pp. 38

Related Party Transactions

Key changes envisaged in the 2013 Act regarding related party transactions include the following:

- The Companies Act of 2013 states that 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 can be entered into only if it is approved by a special resolution at the general meeting.
- No member shall vote on the special resolution if such member is a related party.
- The restrictions will not apply to any transactions entered into by the company in its ordinary course of business other than transactions, which are not on an arm's length basis.
- Every contract or arrangement entered into with a related party shall be referred to in the Board's Report along with the justification for entering into them. Source: http://www.pwc.in/en_IN/in/assets/pdfs/forensic-news-alerts/news-alert-enhancing-governance-with-companies-act-2013.pdf

Investor Protection Measures

The 2013 Act goes a long way in protecting the interests of shareholders. It states that:

- Issue and transfer of securities and non-payment of dividend by listed companies, shall be administered by SEBI by making regulations;
- An act of fraudulent inducement of persons to invest money is punishable with imprisonment for a term which may extend to ten years and with fine which shall not be less than three times the amount involved in fraud;
- A suit may be filed by a person who is affected by any misleading statement or the inclusion or omission of any matter in the Prospectus or who has invested money by fraudulent inducement;
- For the first time, a provision has been made for class action. It states that specified number of members, depositors or any class of them, may, if they are of the opinion that the management or control of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors, file an application before the Tribunal on behalf of the members or depositors;
- Prohibits any person including the director or key managerial person from entering into insider trading; and
- Further, the Act also prohibits directors and key managerial personnel from forward dealings in the company or its holding, subsidiary or associate company.

Regulators

National Company Law Tribunal and Appellate Tribunal

The 2013 Act replaces the High Court with a Tribunal to be known as National Company Law Tribunal (NCLT), which will consist of Judicial and Technical members, as Central Government may deem necessary, to exercise and discharge the powers and functions conferred by the 2013 Act. Appeals from the Tribunal shall lie with the National Company Law Appellate Tribunal and an appeal arising out of order of NCLAT on any question of law shall lie to Supreme Court.

National Financial Reporting Authority

National Financial Reporting Authority (NFRA) will be the new regulator for regulating the audit profession. NFRA shall consist of Chairperson and other part time and the full time members not exceeding 15. The National Financial Reporting Authority shall make recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies or class of companies or their auditors, as the case may be. It will have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit. Any person aggrieved by any order of the National Financial Reporting Authority, may prefer an appeal before the Appellate Authority constituted by the Central Government. Source: *Companies Act, 2013 Fresh thinking for a new start, Deloitte, Page No 16*

Serious Fraud Investigation Office (SFIO)

The Act, 2013 provides legal status to Serious Fraud Investigation Office under Ministry of Corporate Affairs. SFIO will consist of experts from various relevant disciplines including law, banking, corporate affairs, taxation, capital market, information technology and forensic audit. The central government may assign investigation into the affairs of a company to SFIO:⁶

- on receipt of a report of the registrar or inspector,
- on intimation of a special resolution passed by a company that its affairs are required to be investigated,
- in public interest, or
- on request from any department of the central government or state government.
- Investigation report of SFIO filed with the Court for framing of charges shall be treated as a report filed by a Police Officer.
- SFIO will have the power to arrest in respect of certain offences, which attract the punishment for fraud.
- If any case has been assigned by the Central government to SFIO for investigation, no other investigating agency will proceed with investigation in such cases.
- Stringent penalties are prescribed for fraud-related offences.

Conclusion

The new Indian Companies Act, 2013 is a positive and welcoming step towards modernising India's company law and places India on par with corporate legislation elsewhere in the globe. The Act is a progressive and forward looking which promises improved corporate governance norms, enhanced disclosures and transparency, facilitation of responsible entrepreneurship, increased accountability of company managements and auditors and stricter enforcement processes. It goes a long way in protecting the interests of shareholders and removes administrative burden in several areas. The introduction of CSR as an integral function of corporate operations is the most significant step and also the levy of heavier penalties for transgressions from fulfillment of its obligations. Overall, the Act promises to significantly raise the bar on Corporate Governance and will radically alter the framework in a positive sense.

References

1. http://eduvisors.com/dwnld_assets/PDF/Ideas_Insights_by_Eduvisors_CSR_in_Education_and_Impact_of_New_Companies_Bill2.pdf
2. Companies Act 2013, "Key highlights and analysis", PWC, pp. 19-21
3. Companies Act, 2013 "Fresh thinking for a new start", Deloitte, pp.18-20
4. Companies Act – 2013 "New Rules of The game' KPMG", pp. 17-18
5. http://articles.economictimes.indiatimes.com/2013-08-11/news/41295803_1_csr-norms-csr-newcompanies-bill
6. http://www.pwc.in/en_IN/in/assets/pdfs/forensic-news-alerts/news-alert-enhancing-governance-with-companies-act-2013.pdf
7. The Management Accountant, November 2013, Vol. 48, No. 11, pp. 18-49
8. Saumya Jain And Narander Kumar Nigam, Companies Act, 2013 – A New Wave In Corporate Governance, ISSN 2230-7850, Volume-3 | Issue-12 | Jan-2014
9. Understanding Companies Bill 2013: Analysis of Accounting, Auditing and Corporate Governance changes'- Ernst & Young
10. <http://www.mondaq.com/india/x/270182/Corporate+Commercial+Law/Indian+Companies+Act+2013+A+New+Beginning>
11. Companies Act – 2013 New Rules of The game', A Deloitte and ASSOCHAM Report
12. Geetika Vijay (2014), "Corporate Governance under the Companies Act 2013: A More Responsive System of Governance", Volume : 4 | Issue : 4 | Apr 2014 | ISSN - 2249-555X
13. Companies Act, 2013 available at mca.gov.in
14. <http://www.icsi.edu/WebModules/LinksOfWeeks/SEP2013.pdf>
15. <https://www.bcasonline.org/articles/artin.asp?1112>
16. Implications of Companies Act, 2013 Governance, Grant Thornton
17. <http://diplomacyandforeignaffairs.com/companies-act-2013-a-paradigm-shift>