Companies Amendment Act 2017: an overview of key changes
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Dear reader,

We are delighted to share with you our publication **Companies Amendment Act 2017: an overview of key changes**.

The enactment of the Companies Act, 2013 (the 2013 Act or the Act) was one of the most significant legal reforms in India, aimed at bringing Indian companies law in line with the global standards. The Act introduced significant changes in the companies law in India, especially in relation to accountability, disclosures, investor protection and corporate governance.

On many fronts, constituents faced significant implementation challenges. The Government continued to receive representations from several quarters for further review and simplification of the 2013 Act. Against this background, the Ministry of Corporate Affairs (MCA) constituted a Companies Law Committee (Committee) for addressing these concerns. The Committee had to deal with more than 2,000 comments received from different sources. Given the sheer enormity and complexity of the exercise, it is indeed a commendable feat that the Committee could finalise its report in a little more than six months.

The Government considered many of the suggestions made by the Committee and introduced the Companies (Amendment) Bill 2016 (the 2016 Bill) in the Lok Sabha in March 2016. It was later referred to the Standing Committee on Finance for further examination. After considering the suggestions of the Standing Committee and other related developments, the 2016 Bill renamed as the Companies (Amendment) Bill 2017 (the 2017 Amendment Bill) was reintroduced in Lok Sabha and passed in July 2017. The 2017 Amendment Bill was approved by the Rajya Sabha on 19 December 2017. It got assent from the Honourable President of India on 3 January 2018 and has been notified in the Official Gazette of the same date to be an Amendment to the 2013 Act (the 2017 Amendment Act).

The 2017 Amendment Act addresses difficulties in implementation, facilitates ease of doing business helps achieving better harmonisation with other statutes such as the Reserve Bank of India Act, 1934 and regulations made thereunder, and rectifies inconsistencies in the 2013 Act. We compliment the Government of India for adopting a highly collaborative approach and addressing the various challenges.

Our publication covers an overview of key changes brought by the 2017 Amendment Act. The new legislation and changes introduced by it are very vast and therefore we decided to focus on some key topics, which are broadly categorised into: definitions, loans and investments, related party transactions (RPT), corporate social responsibility, corporate governance, declaration and payment of dividend, financial reporting, audit and auditors, board matters, managerial remuneration, acceptance of deposits by companies, merger, amalgamation and reconstruction and other matters.

We hope you will find this publication useful in having a better understanding of the changes. We look forward to your feedback.

Yours sincerely,

EY
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**Definitions**

### Holding company

Section 2(46) of the 2013 Act defines the term ‘holding company’ as below:

“Holding company, in relation to one or more other companies, means a company of which such companies are subsidiary companies.”

Unlike the definition of the term ‘subsidiary company’, this definition does not contain any reference to a body corporate. A foreign company is not a company under the 2013 Act; rather, it is a body corporate. Thus, there were apprehensions that it may result in a few anomalies. For example, it may be argued that a foreign parent is not a holding company/related party under the 2013 Act.

To remove this anomaly, the section has been amended by the 2017 Amendment Act to include an explanation that for the purposes of this section, company includes body corporate.

We believe it is a minor amendment aimed at correcting an anomaly. It should not have significant financial reporting implication.

### Subsidiary

Under section 2(87) of the 2013 Act, ‘subsidiary company’ is defined based on control over the composition of the board of directors, or control over more than one-half of the total share capital. For this purpose, ‘total share capital’ comprises the aggregate of paid up equity share capital and convertible preference share capital. Hence, under the 2013 Act, a company may be treated as a subsidiary of the other company merely based on ownership of optionally convertible redeemable preference shares, which are in substance loan and contain conversion option only for security purposes.

To address the anomaly, the 2017 Amendment Act states that instead of ‘total share capital’, control over more than one-half of ‘total voting power’ will be the criteria to identify a subsidiary company.

We welcome the change as it will rightly ensure that an optionally convertible loan does not on its own result in the company being identified as a subsidiary of the loan provider. Upon notification of the 2017 Amendment Act, the definition of ‘subsidiary company’ under the 2013 Act (as amended) is consistent with AS 21 Consolidated Financial Statements, notified under the Companies (Accounting Standards) Rules 2006 (as amended). However, the definition will continue to be different from that under Ind AS (IFRS converged standards)

 instead of ‘total share capital’, control over more than one-half of ‘total voting power’ will be the criterion to identify subsidiary. This will align ‘subsidiary’ definition under the 2013 Act with AS 21 Consolidated Financial Statements. However, it will continue to be different from definition under Ind AS.
Associate company

Section 2(6) of the 2013 Act defines the term ‘associate company’, amongst other matters, based on control of at least 20% of total share capital. Hence, this definition also results in issues/challenges similar to those for the definition of the term ‘subsidiary company.’

To address the above issues, the 2017 Amendment Act states that ‘significant influence’ would mean control of at least 20% of the total voting power (instead of total share capital) or control or participation in business decision under an agreement.

In our view, the definition of an associate company should provide for participation in business decisions rather than control thereof. If an investor exercises control over the business decisions, then the company on which the control is exercised is a subsidiary company and not an associate company. We recommend that this confusion should be addressed by the MCA and the difference between subsidiary company and associate company should be clearly articulated.

Joint venture

Under the 2013 Act, the definition of the term ‘associate company’ states that it also includes ‘joint venture company’. However, joint venture is not defined.

In the 2017 Amendment Act, an explanation to the definition of the term ‘associate company’ is added to explain joint venture. In accordance with the explanation, ‘joint venture’ will mean a ‘joint arrangement’ whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. However, the 2017 Amendment Act does not define the term ‘joint arrangement’.

We understand that the objective of the change is to bring definitions more in line with accounting standards, particularly Ind AS. However, this change may not fully meet the desired objective. Under Ind AS, strategic investments of a company are classified into the following three separate categories:

a) Subsidiaries, i.e., entities controlled by the reporting entity
b) Joint arrangements, i.e., arrangements jointly controlled by the reporting entity with one or more third parties. Joint arrangements may be further classified as either joint operations or joint ventures
c) Associates, i.e., entities that are neither controlled nor jointly controlled by the reporting entity; however, the reporting entity exercises significant influence over these entities

We suggest that the MCA should consider these relationships carefully whilst defining the terms so that they are not overlapping and are in sync with the notified Ind AS. This will ensure that definitions for legal/regulatory purposes are aligned to the definition used for accounting purposes. If this is not done, identification of subsidiaries, associates and joint ventures for legal/regulatory purposes will continue to be different from that for accounting purposes, which can cause confusion.
In accordance with section 2(57) of the 2013 Act, ‘net worth’ means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation.

In the absence of a specific mention, there was a debate as to whether ‘net worth’ included ‘debit or credit balance of the profit and loss account’. The 2017 Amendment Act addresses this debate by specifically including the phrase ‘debit or credit balance of the profit and loss account’ in the definition of ‘net worth’. In our view, the net worth of a company reflects its intrinsic value. Hence, this is a clarificatory change, one that was important to make.

On transition to Ind AS, companies are typically required to apply Ind AS retrospectively. However, Ind AS 101 First-time Adoption of Ind AS provides specific exemption/exceptions to the retrospective application. The resulting profit or loss impact is adjusted directly in the retained earnings. Under Ind AS, companies also recognise various gains and losses in the other comprehensive income (OCI) on an ongoing basis. Some of these gains and losses are subsequently reclassified to the statement of profit and loss (P&L) and other are not subsequently reclassified to the P&L. Given below are few examples of gains and losses recognised directly in the OCI:

- Exchange differences on translation of foreign operations (foreign branches), i.e., foreign currency translation reserve (FCTR) – to be recycled to P&L
- Cash flow hedge reserve – to be recycled to P&L

The definition is not absolutely clear on whether amounts recognised in OCI/retained earnings in this manner on transition to Ind AS or subsequently will be included in the net worth. Also, it is not clear whether these amounts will be included in ‘net worth’ upfront or on realisation. We share our perspectives on these issues.

In the absence of a specific mention, there was a debate as to whether ‘net worth’ included ‘debit or credit balance of the profit and loss account’. The 2017 Amendment Act addresses this debate by specifically including the phrase ‘debit or credit balance of the profit and loss account’ in the definition of ‘net worth’. In our view, the net worth of a company reflects its intrinsic value. Hence, this is a clarificatory change, one that was important to make.
With regard to adjustments arising on first-time adoption of Ind AS, pending clear guidance from the regulator, the following assumptions may be made on the basis that net worth reflects the intrinsic worth of a company:

- Ind AS are notified under the 2013 Act. The company prepares its first Ind AS financial statements, including the opening Ind AS balance sheet, in accordance with Ind AS. Hence, the accounting treatment adopted by the company has legal backing of the 2013 Act.

- The definition of term ‘net worth’ refers to the ‘audited balance sheet’. This further supports the argument that the accounting treatment adopted in the financial statements should be respected.

- In accordance with the definition, ‘net worth’ includes ‘all reserves created out of the profits’. The word ‘profit’ is a wide term and may include even amounts recognised directly in the retained earnings in accordance with Ind AS 101. For example, a first-time adopter measures its investment in mutual funds at fair value on the transition date and recognises the resulting fair value gain directly in retained earnings. Such gain is included in ‘net worth’ as it is a reserve created out of profits (which is recognised in retained earnings on first-time adoption of Ind AS). However, consider another example where a company decides to use revaluation model for its property, plant and equipment (PPE) at the transition date and on a go forward basis. This is different from the use of fair value as deemed cost exemption for PPE at transition date (refer discussion below). In this case, revaluation gain is credited to revaluation reserve. The reserves created out of revaluation of assets will not be included in the net worth but will be included in the net worth to the extent and when realised.

- The 2017 Amendment Act specifically includes debit or credit balance of the P&L account as part of net worth.

- The definition excludes ‘reserves created out of revaluation’ from the net worth. It may be argued that the decision on what is revaluation and what is not should be as per the applicable accounting standards. In accordance with Ind AS for PPE, transition date measurement at fair value based on deemed cost option in Ind AS 101 is not revaluation.

With regard to ongoing adjustments recognised directly in the OCI, one may need to consider the nature of adjustments carefully to decide their inclusion or exclusion from net worth. For example, with regard to remeasurement adjustments recognised in OCI in accordance with Ind AS 19 Employee Benefits and transferred to retained earnings, it may be argued that these adjustments are not in the nature of ‘reserves created out of revaluation of assets’ and hence should be included in the net worth determination. However, for OCI adjustments such as gains on fair valuation of FVTOCI equity investments, one argument is that these are ‘reserves created out of revaluation of assets’. Hence, they should be excluded from determination of net worth. However, those gains will be included in net worth to the extent and when realised. In contrast, some may also argue that fair valuation in accordance with the requirements of Ind AS 109 Financial Instruments is not the same as revaluation of assets, for example, revaluation of PPE using the revaluation model. Therefore, the fair valuation gain should be included in the net worth. We believe that in the absence of clear guidance, both the views can be accepted. In either case, any losses on fair valuation of FVTOCI equity investment are deducted from net worth immediately.

In the absence of specific guidance, these views may be challenged. We suggest the MCA should clarify these issues through an appropriate notification/circular.
Free reserves

In accordance with the 2013 Act, the term ‘free reserves’ means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend:

Provided that

a) Any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or

b) Any change in carrying amount of an asset or of a liability recognised in equity, including surplus in P&L on measurement of the asset or the liability at fair value,

Shall not be treated as free reserves.

The manner in which the term ‘free reserves’ is defined, particularly its proviso (a), suggests that unrealised gains, whether shown as reserves or credited to P&L/OCI, are not free reserves. Thus, if a company has recognised foreign exchange gains on translation of receivable, payables or loans in accordance with Ind AS 21 The Effects of Changes in Foreign Exchange Rates or recognised mark-to-market gains on derivative contracts in accordance with Ind AS 109 Financial Instruments, such gains are not treated as free reserves. A company includes these amounts in free reserves upon realisation, e.g., when receivable is realised or derivative is settled. Interestingly, any unrealised losses on them will be treated as a reduction of the free reserves. The application of this principle creates practical challenges. Tracking the unrealised gains and its subsequent realisation on an individual item basis will be a very cumbersome exercise.

In accordance with the definition, the term ‘free reserves’ does not include any amount representing unrealised/notional gains, whether shown as a reserve or otherwise (Emphasis added).

To apply this principle in practice and determine free reserves correctly, a company will need to track separately and identify when each gain is realised in cash. Till such realisation, gain cannot be included in free reserves. It does not matter whether the gain is recognised in P&L, OCI or directly in reserves. This will make identification of free reserves quite challenging.

The above principles will apply with regard to identification of free reserves for adjustments arising on first-time adoption of Ind AS and on-going Ind AS adjustments.

As can be seen from the above, the determination of free reserves is extremely onerous and effectively requires companies to determine profits on cash basis of accounting, and losses on accrual basis. Consequently, adjustments will be required for many more items than what may be apparent. For example, free reserves will be reduced by items such as deferred tax assets, rate regulated assets and fair valuation of defined benefit plan assets.

These matters are not beyond doubt and can be challenged. We recommend that the MCA should consider addressing these issue and provide appropriate guidance on them.

Practical perspective

The 2017 Amendment Act does not prescribe any change with regard to the definition. Consequently, from a practical perspective, the following issues will continue to arise.

The definition of the term ‘free reserves’ appears to be based on the principle that a company should not include unrealised gains, but unrealised losses are included for computing free reserves. One common example of a reserve that may typically get excluded is revaluation surplus forming part of OCI created on upward revaluation of PPE. A company that is applying hedge accounting principles will exclude hedging reserve from the ‘free reserves’ if the hedging reserve has a positive (credit) balance. If the hedging reserve has a negative (debit) balance, it will be deducted from free reserves. Similarly, a company that has a foreign branch will exclude accumulated gains on foreign currency translation of the branch. However, accumulated losses on translation will reduce free reserves.
**Turnover**

Section 2(91) of the 2013 Act defines the term ‘turnover’ to mean the aggregate value of the realisation from the sale, supply or distribution of goods, or on account of services rendered, or both, by the company, during a financial year.

From the definition, it was not clear whether indirect taxes such as excise duty/Goods and Services Tax (GST) will be included in or excluded from turnover. From a financial reporting perspective, a company collects GST on behalf of the Government and therefore it is excluded from revenue. Consequently, it was not clear whether the determination of turnover under the 2013 Act will be in line with the financial statements or it will be the gross amount received from customer.

To address these issues, the 2017 Amendment Act contains a new definition of ‘turnover’. In accordance with the new definition, ‘turnover’ means the gross amount of revenue recognised in the P&L account from the sale, supply, or distribution of goods or on account of services rendered, or both, by a company during a financial year. Hence, going forward, revenue recognised in the financial statements will be turnover under the statute as well.

**Debenture**

Section 2(30) of the 2013 Act contains a broad definition of the term ‘debenture’. It states that ‘debenture’ includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not (Emphasis added).

Many stakeholder pointed out to the Companies Law Committee that the phrase ‘any other instrument of a company evidencing a debt’ has made the definition very broad and included instruments such as commercial papers and other money market instruments, which are often used as an important short-term fund raising source by eligible companies and are well regulated under the RBI regulations. These stakeholders were of the view that treatment of money market instruments and such other instruments as debentures gives rise to significant practical difficulties for the concerned companies.

The Committee agreed with the above concerns and suggested appropriate changes be made to the definition of the term ‘debenture’.

The term ‘debenture’ will not include money market instruments, which are used for short-term fund raising by eligible companies and are regulated under the RBI regulations.

In line with the suggestions, the 2017 Amendment Act states that the term debenture will not include the following:

a) Instruments referred to in Chapter III-D of the Reserve Bank of India Act, 1934. Chapter III-D of the RBI Act regulates transaction in derivatives, money market instrument, securities etc. Money market instruments include call or notice money, term money, repo, reverse repo, certificate of deposit, commercial usance bill, commercial paper and such other debt instrument of original or initial maturity up to one year as the RBI may specify from time to time.

b) Such other instrument, as may be prescribed by the Central Government in consultation with the RBI.

We welcome this change.
Interested director

Whilst section 2(49) of the 2013 Act defined the term ‘interested director’, it was not used in other sections of the 2013 Act. Section 184(2) specifically provides the nature of interests to be disclosed by directors, but does not use the term ‘interested director’. Section 174(3) dealing with the quorum for meetings of the board clarified that the meaning of the term ‘interested director’ would be the same as under section 184(2). Due to redundancy, the definition of the ‘interested director’ provided in section 2(49) has been omitted.

Key managerial personnel

Section 2(51) of the 2013 Act defined the term ‘key managerial personnel (KMP)’, in relation to a company, as the chief executive officer (CEO), managing director or manager, company secretary, whole-time director, chief financial officer (CFO) and such other officer as may be prescribed. Rule 8 of the ‘Appointment and Remuneration of Managerial Personnel Rules’ specifies that every listed company and every other public company having a paid-up share capital of INR10 crore or more will have whole-time KMP. A plain reading of the above definition suggests that there is a limit on officers who can be designated as KMP. The Companies Law Committee was of the view that a flexibility should be given to companies for designating other whole-time officers as KMP of the company. The Committee therefore recommended that the board may be empowered to designate other whole-time officers of the company as KMP.

The 2017 Amendment Act contains appropriate changes in section 2(51) to incorporate this suggestion. In accordance with the changes, the board of directors of a company will have the power/authority to designate the officers, not more than one level below the directors who are in whole-time employment, as KMP of the company.
Multi-layering of investment companies

Section 186 of the 2013 Act prohibits a company from making investment through more than two layers of investment companies. Many stakeholders have raised concerns that these restrictions are not in line with the requirements of modern business and will be a significant impediment to the ease of doing business. For example, many conglomerates need multi-layer investment structures for reasons such as fund-raising, creating sector-specific sub-groups and private equity (PE) investment. Companies also need these structures to raise finance where the PE investor wants to invest in specific businesses or group of entities, instead of making investment beyond such numbers as may be prescribed. Till sometime back, the MCA had not specified any companies under this proviso. Hence, this restriction was earlier not applicable.

On 28 June 2017, the MCA issued a public notice indicating its intention to enact this proviso in section 2(87) and invited public comment on related draft rules. After considering the comments received, the MCA has recently notified the applicability date for the proviso to section 2(87) of the 2013 Act. The MCA has also notified the Companies (Restriction on number of layers) Rules 2017. The proviso and these rules are applicable from the date of publication in the Official Gazette, viz., 20 September 2017. The rules provide for the following:

a) A holding company is allowed to have up to two layers of subsidiaries. In computing the layers under this rule, one layer that is represented by a wholly owned subsidiary will not be taken into account.

b) These restrictions are in addition to the layering restrictions under section 186(1), which prohibit a company from making investment through more than two layers of investment companies. Investment companies will also be included in the count for the purposes of layer requirements under the new rule.

c) The restriction does not prohibit a holding company from acquiring a subsidiary incorporated in a country outside India if such subsidiary has layers as per the laws of such country.

d) The provisions of this rule do not apply to the following classes of companies, i.e., they can continue to have more than two layers of subsidiaries:

(i) A banking company
(ii) A systemically important non-banking financial company (NBFC) registered with the Reserve Bank of India
(iii) An insurance company
(iv) A government company referred to in clause (45) of section 2 of the Act

In view of reports suggesting misuse of multiple layers of companies for diversion of funds or money laundering, the Government has decided that the 2013 Act should retain restriction on layers of companies at the ultimate parent level. Considering these aspects, the Companies Law Committee, the Standing Committee and the 2016 Bill had recommended for the removal of the provision relating to restriction on layers of companies.

However, subsequently, in view of reports of misuse of multiple layers of companies, where companies create shell companies for diversion of funds or money laundering, the Government has decided to retain these provisions. Accordingly, the 2017 Amendment Act does not contain any change on the matter. This indicates that restrictions on layering contained in the 2013 Act will continue to apply on a go forward basis as well.

In addition, it may be noted that definition of the term ‘subsidiary company’ in section 2(87) of the 2013 Act contains a proviso whereby such class or classes of holding companies as may be prescribed will not have layers of subsidiaries.
e) Every company, other than exempt companies referred to in (d) above, existing on or before the commencement of these rules, which has number of layers of subsidiaries in excess of the permitted layers, will comply with the following transitional provisions:

(i) The company will file with the Registrar a return in Form CRL-1 disclosing the details specified therein, within 150 days from the date of application of these rules.

(ii) The company will not, after the date of commencement of these rules, have any additional layer of subsidiaries over and above the layers existing on such date.

(iii) The company will not, in case one or more layers are reduced by it subsequent to the commencement of these rules, have the number of layers beyond the number of layers it has after such reduction or maximum layers allowed in sub-rule (1), whichever is more.

f) If any company contravenes any provision of these rules, the company and every officer of the company who is in default will be punishable with fine that may extend to INR10,000 and, where the contravention is a continuing one, with a further fine that may extend to INR1,000 for every day after the first during which such contravention continues.

Loans and investments

Loans to directors etc.

In accordance with section 185 of the 2013 Act, a company cannot provide loan, guarantee or security to any of its directors or to any other person in whom the director is interested. One of the outcomes of the term ‘person in whom director is interested’ was that a company could not give a loan even to its subsidiary, associate or joint venture companies. This has created significant challenges for many groups, particularly cases where investee companies are significantly dependent on the investor for financing. The MCA tried addressing these concerns through rules/notifications. However, they were not comprehensive. Also, there was a concern that rules may be overriding the Act.

To address these issues comprehensively, the 2017 Amendment Act replaces the current requirement of section with a completely new section 185. Given below is an overview of the key requirements in the new section:

a) A company will not provide loan, guarantee or security in connection with a loan to any director, director of the holding company or any partner or relative of any such director or any firm in which any such director or relative is a partner.

b) Loan to other persons or parties in whom the director is interested can be given if both the following conditions are met:

a) A special resolution is passed by the company in the general meeting. The explanatory statement to the notice for the relevant general meeting should disclose the full particulars of the loans or guarantee given or security provided and the purpose for which the loan or guarantee or security is proposed to be utilised by the recipient and any other relevant facts.

b) The loans are utilised by the borrowing company for its principal business activities.

The new section 185 states that the above prohibitions/restrictions will not apply in the following cases. However, the loans made under clauses (c) and (d) below should be utilised by the subsidiary company for its principal business activities:

a) A loan given by a company to a managing or whole-time director either as part of the conditions of service extended by the company to all its employees, or pursuant to a scheme approved by the members by a special resolution

b) A company which in the ordinary course of its business provides loans or gives guarantees or securities for the due repayment of any loan and in respect of such loans an interest is charged at a rate not less than the rate of the prevailing yield of one-year, three-year, five-year or ten-year Government security closest to the tenor of the loan

c) Any loan made by a holding company to its wholly owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company

d) Any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company

We welcome the revision of section 185. It is likely to address many practical issues which had arisen on the application of the 2013 Act.

Loans to employees

Section 186(2) of the 2013 Act contains specific prohibitions/restriction on provision of loan/guarantee/security etc. to a person or body corporate. The occurrence of the word ‘person’ in the section unwittingly seemed to cover employees. The Companies Law Committee was of the view that loans which are given to employees as part of service conditions or pursuant to an
approved scheme for all employees by the company should not be covered under this section. This section was meant to cover intercorporate loans and not loans to employees.

The 2017 Amendment Act clarifies that for the purposes of this sub-section, the word ‘person’ does not include any individual who is in the employment of the company. Consequently, loans to employees will not be subject to restrictions under section 186(2).

Loans and investments by holding company

Section 186 of the 2013 Act requires that a company will not (i) give loans to any person/other body corporate, (ii) give guarantee or provide security in connection with a loan to any person/other body corporate and (iii) acquire securities of any other body corporate, exceeding the higher of:

a) 60% of its paid-up share capital, free reserves and securities premium, or
b) 100% of its free reserves and securities premium.

The changes made in the rules were helpful to address the practical challenges faced by companies. However, there was a concern that the rules were overriding the requirements of the 2013 Act. To address this concern, the 2017 Amendment Act has included relaxations, which were available in rules, as part of the Act itself. The changes made in the 2017 Amendment Act state that where a loan or guarantee is given or where a security has been provided by a company to its wholly owned subsidiary company or a joint venture company, or acquisition is made by a holding company, by way of subscription, purchase or otherwise of, the securities of its wholly owned subsidiary company, the requirement related to approval by special resolution at the shareholders’ meeting will not apply. However, the company will disclose the details of such loans or guarantee or security or acquisition in the financial statements.

Section 186(7) of the 2013 Act requires that no loan will be given under section 186 at a rate of interest lower than the prevailing yield of one year, three year, five year or ten year government security closest to the tenor of the loan. On the lines of rules notified under the 2013 Act, the 2017 Amendment Act does not contain any relaxation in this regard. Hence, a company needs to charge interest at the specified rate on all its loans, including loans given to wholly owned subsidiaries, other subsidiaries and joint ventures.

Restrictions on powers of the board

Section 180(1)(c) of the 2013 Act requires that if money proposed to be borrowed together with the money already borrowed by the company exceeds the aggregate of its paid-up share capital and free reserves, a special resolution should be passed by the company for borrowing money. Hence, the securities premium amount is not included in this computation. The 2017 Amendment Act amends section 180(1)(c) so that it includes securities premium along with paid-up share capital and free reserves for the calculation of maximum limits on the borrowing powers of the board.
The requirements concerning RPTs have been a matter of significant debate since their introduction in the 2013 Act. The 2017 Amendment Act contains the following key changes primarily aimed at addressing practical difficulties in the application:

### Definition of ‘related party’

#### Company vs. body corporate

The definition of the term ‘related party’ in section 2(76) of the 2013 Act used the word ‘company’, e.g., it used the words ‘holding’, ‘subsidiary’ or ‘associate’ company. Foreign company is not a company under the 2013 Act; rather, it is a body corporate. Thus, some may have interpreted the definition of the term ‘related party’ to include only companies/entities incorporated in India within its purview. Such an interpretation will have a consequence that companies/entities incorporated outside India, such as foreign holding/subsidiary/associate/fellow subsidiary of an Indian company, were excluded from the purview of related party requirements for an Indian company. This was not the intention of the government and such an interpretation may have seriously diluted compliance with related party requirements under the 2013 Act.

To address this issue beyond any doubt, the 2017 Amendment Act substitutes the word ‘company’ with the word ‘body corporate.’ Hence, upon enactment of the 2017 Amendment Act, it is now absolutely clear that a body corporate that is a holding/subsidiary/associate/fellow subsidiary of an Indian company should be treated as related party.

#### Investor in associate company

Under the existing definition of the term ‘related party’ given in section 2(76) of 2013 Act, associate company is a related party for the investor in that company. However, for the associate company itself, investor is not a related party. The 2017 Amendment Act fixes this anomaly and requires that both associate company and investor should be treated as related to each other.

### Voting rights

The second proviso to Section 188(1) of the 2013 Act states that a member who is a related party will not be entitled to vote on special resolutions or approve any contract or arrangement that may be entered into by the company. Since section 47 of the 2013 Act is the primary section dealing with members that are entitled to vote and the proportion of their voting rights, the 2017 Amendment Act clarifies that the requirement of section 47 will be subject to section 188(1). In other words, the right of every member holding equity shares to vote on all resolutions placed before the shareholders meeting would not be applicable to members who are related parties and prohibited from voting under section 188.
Approval of related party transactions

Section 188 of the 2013 Act requires RPTs to be approved by an ordinary resolution of disinterested shareholders if they do not meet the prescribed exemption criteria. The 2013 Act states that no member of the company will vote on such ordinary resolution if such member is a related party. Compliance with this requirement may be particularly challenging in certain cases. For example, compliance with this requirement will be challenging for companies that are closely held or are a joint venture between 2-3 shareholders since all shareholders will be related parties. To address this issue, the 2017 Amendment Act states that a company wherein 90% or more members in number are relatives of the promoter or are related parties, all shareholders will be entitled to vote on the ordinary resolution.

Section 188 (3) of the 2013 Act deals with a scenario where any contract or arrangement is entered into by a director or any other employee without obtaining the consent of the board and/or approval by an ordinary resolution in the general meeting. The section states that if the contract/arrangement is not ratified by the board or, as the case may be, by the shareholders at a meeting within three months from the date on which such contract or arrangement was entered into, then such contract or arrangement will be voidable at the option of the board. Further, if the contract or arrangement is with a related party to any director, or is authorised by any other director, the directors concerned will indemnify the company against any loss incurred by it. The 2017 Amendment Act states that apart from being voidable at the option of the board, the contract/arrangement would also be voidable at the option of the shareholders.

The third proviso to Section 188(1) has reference to the terms ‘ordinary course of business’ and ‘arm’s length basis’. The Companies Law Committee had considered a suggestion that these terms may be clarified/defined. The Committee was of the view that these terms are known in general commercial parlance and enough accounting guidance is available. The Committee therefore did not recommend any change in the 2013 Act/ Rules on these matters. Rather, it was suggested that the ICAI may consider issuing suitable guidance notes on these matters to guide its members.

In line with the Committee’s recommendations, the 2017 Amendment Act does not contain any change on this matter.

Audit Committee pre-approval of RPT

Under section 177 of the 2013 Act, the Audit Committee is required to pre-approve all RPTs and subsequent modifications thereto. In contrast, section 188 requires the board and/or shareholders to pre-approve only specific RPTs. Also, section 188 contains two exemptions from the approval process, viz., transactions are entered into by the company in its ordinary course of business and on an arm’s length basis, or they do not exceed prescribed materiality threshold.

The 2017 Amendment Act does not prescribe changes to align the Audit Committee pre-approval requirements with the RPT approval requirements under section 188. However, it clarifies that if the Audit Committee does not approve transactions not covered under section 188, the Audit Committee will make its recommendations to the board. This will require the board to consider and approve these RPTs even if they were otherwise not covered under the approval requirement of section 188.

The 2017 Amendment Act clarifies that RPTs between a holding company and its wholly owned subsidiaries will not require the approval of the Audit Committee. However, if these transactions require board approval under section 188, then they will also require approval of the Audit Committee.

If Audit Committee does not approve RPT not covered under section 188, the Committee will make its recommendations to the board. The board will need to consider and approve such RPTs.

The 2017 Amendment Act somewhat relaxes Audit Committee pre-approval requirements for RPTs. Based on the relaxation given, a director or officer of the company may enter into a related transaction for an amount not exceeding INR1 crore, without obtaining prior approval of the Audit Committee. However, such transaction should be ratified by the Audit Committee within three months from the date of the transaction. In the absence of such ratification, the transaction will be voidable at the option of the Audit Committee. Also, if the transaction is with a related party to any director or is authorised by any other director, the director concerned will indemnify the company against any loss incurred by it.

We welcome most of the changes above. However, with regard to Audit Committee pre-approval of RPT’s, we continue to believe that the Audit Committee and independent directors (IDs) should not have executive responsibility to approve RPT’s. They should be responsible for reviewing RPT’s and not approving the same.
The 2013 Act, amongst other matters, requires that every company with a net worth of INR500 crore or more, turnover of INR1,000 crore or more or a net profit of INR5 crore or more during any financial year will constitute a CSR committee. The said committee will consist of three or more directors, out of which at least one director should be an ID. The 2017 Amendment Act contains the following key changes:

a) The meaning of the words ‘during any financial year’ used in section 135(1) is not clear. In the absence of such clarification, differing views are possible as to whether a company should consider net worth/turnover/net profit for the immediately preceding financial year or the current financial year. To address this issue, the 2017 Amendment Act replaces the words “during any financial year” with the words “during the immediately preceding financial year.” Hence, the applicability of CSR requirement will be decided based on net worth/turnover/net profit for the immediately preceding financial year.

b) The 2013 Act contains different criteria for applicability of CSR and appointment of IDs. Based on the prescribed criteria, a company that is not otherwise covered under the ID appointment requirements may also need to appoint an ID for purposes of inducting into the CSR committee. Considering this, the CSR rules have stated that a non-listed public company or a private company, which is not required to appoint an ID, can have its CSR committee without an ID.

Since the requirement to have an ID on the CSR committee was arising from the 2013 Act, there was a concern that the CSR rules may be overriding the 2013 Act. The 2017 Amendment Act addresses this concern by including CSR rules clarification in the Act itself. The 2017 Amendment Act states that where a company is not required to appoint an ID under section 149(4), it will constitute the CSR committee with two or more directors.
c) An explanation to section 135(5) of the 2013 Act states that for the purpose of this section, the average net profit will be calculated in accordance with section 198. Section 198 deals with calculation of profit for managerial remuneration and requires specific addition/deduction to be made in the profit for the year. In addition to this, the CSR rules state that whilst calculating net profit, any profit arising from overseas branches of the company and dividend received from other companies in India covered under section 135 should be reduced. Since section 198 does not contain these deductions, there was an apparent conflict between the two requirements. To address this issue, the 2017 Amendment Act states that the Central Government may prescribe sums which will not be included for calculating net profit of a company under section 135.

d) Rule 3 of the CSR rules clarifies that foreign companies are also required to comply with the provisions of CSR. However, section 384 of the 2013 Act, which prescribes the applicability of various provisions to a foreign company, does not specify the applicability of CSR requirements. To bring absolute clarity, the 2017 Amendment Act contains a corresponding change in section 384 of the 2013 Act, i.e., section 135 relating to CSR will also apply to a foreign company if it meets the prescribed criteria for its India business.

The 2013 Act requires the board of each company covered under the CSR to ensure that the company spends, in every financial year, at least 2% of its average net profits made during the three immediately preceding financial years in pursuance of its CSR policy. Neither the 2013 Act nor the CSR rules prescribe any specific penal provision if a company fails to spend the amount. Also, there is no legal obligation on companies to make good the deficiency of one year in the subsequent years. However, the board, in its report, needs to specify the reasons for not spending the specified amount. The Companies Law Committee considered a suggestion as to whether companies should be required to carry forward unspent amounts and to transfer any unspent balance for five years to one of the funds listed in Schedule VII of the 2013 Act. The Committee was of the view that whilst a carry forward might be desirable, the requirement for mandatorily transferring the unspent amount at the end of five years would go against the principle of ‘comply or explain’ and would not be appropriate. Hence, the Committee recommended the continuance of the current provisions, where the actual expenditure was reported with no obligation to carry over.

There is no legal obligation on companies to make good deficiency in CSR spend of one year in subsequent years. However, the board, in its report, should specify reasons for not spending the specified amount.
Independent directors

Section 149(6) of the 2013 Act prescribes criteria for selection of IDs. One of the criteria is that ID should have/had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters or directors, during the two immediately preceding financial years or during the current financial year. Based on the wording used in the 2013 Act, even minor pecuniary relationships may render a person ineligible for appointment as an ID. In contrast, under the SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015, only ‘material’ pecuniary relationships disqualify a person for appointment as an ID. The 2017 Amendment Act introduces the materiality concept for determining whether pecuniary relationships impact independence. In accordance with the 2017 Amendment Act, remuneration as director or transaction not exceeding 10% of a person's total income or such amount as may be prescribed will not impair independence.

The materiality concept has been introduced for determining whether pecuniary relationships impact independence.

Section 149(6) also prescribes that a person cannot be appointed as an ID if any of his or her relatives has or had a pecuniary relationship or transaction exceeding a prescribed value with the company, its holding, subsidiary or associate company or their promoters or directors during the two immediately preceding financial years, or during the current financial year. The 2017 Amendment Act clarifies this requirement by prescribing separate limits for holding of security/interest, indebtedness, provision of guarantee/security and other pecuniary relationships. The 2017 Amendment Act requires that relatives of the ID:

a) Should not hold any security or interest in the company, its holding, subsidiary or associate company during the two immediately preceding financial years or during the current financial year. However, the relative may hold security or interest in the company of face value not exceeding INR50 lakh or 2% of the paid-up capital of the company, its holding, subsidiary or associate company or such higher sum as may be prescribed.

b) Should not be indebted to the company, its holding, subsidiary or associate company or their promoters, or directors, in excess of such amount as may be prescribed during the two immediately preceding financial years or during the current financial year.

c) Should not have given a guarantee or provided any security in connection with the indebtedness of any third person to the company, its holding, subsidiary or associate company or their promoters, or directors of such holding company, for such amount as may be prescribed during the two immediately preceding financial years or during the current financial year.

d) Should not have any other pecuniary transaction or relationship with the company, or its subsidiary, or its holding or associate company amounting to 2% or more of its gross turnover or total income singly or in combination with the transactions referred to above.

Section 149(6) also prohibits the appointment of an individual as an ID if that person or his or her relative is/was a KMP or an employee in the company, its holding, subsidiary or associate company during any of the preceding three financial years. The Committee was of the view that a person's independence is likely to be impacted only if the relative held a significant position such as director or KMP during the preceding years. Accordingly, the 2017 Amendment Act clarifies that a relative who was merely an employee during the preceding three financial years will not impact independence. However, no change in the prohibition has been made with regard to the person's own employment.

The changes will ease the burden of ensuring independence for companies as well as their IDs. However, there are no changes to ease highly onerous obligations on IDs including taking several executive responsibilities.
The above changes are likely to ease the burden of ensuring independence for companies as well as their IDs. However, the 2017 Amendment Act does not contain any change with regard to highly onerous obligations on IDs including taking several executive responsibilities. Consequently, IDs will continue to be required to approve RPTs, conduct one separate meeting without attendance of non-IDs, protect whistle-blowers, safeguard the interest of all stakeholders, particularly the minority shareholders, and perform the delicate act of balancing conflicting interests of stakeholders, which includes the environment. We recommend that MCA may reconsider these matters.

Audit Committee

Section 177 of the 2013 Act requires each listed company and such other class of companies, as may be prescribed, to constitute an Audit Committee. In accordance with the board rules, non-listed public companies meeting either of the following criteria need to constitute an Audit committee:

a) Non-listed public companies having paid-up share capital of INR10 crore or more
b) Non-listed public companies having a turnover of INR100 crore or more
c) Non-listed public companies with aggregate outstanding loans, or borrowings, or debentures or deposits of INR50 crore or more

It was noted that the requirement for constitution of an Audit Committee largely applied to public companies, either listed or meeting the prescribed criteria. However, a private company that had listed its debt instruments as per the SEBI Debt Listing Regulations also needed to comply with these requirements. The Companies Law Committee was of the view that constitution of an Audit Committee by private companies would not serve much purpose. Hence, they should not be required to constitute an Audit Committee.

To address this issue, 2017 Amendment Act states that instead of listed companies, listed public companies should be required to constitute an Audit Committee. In addition, prescribed class of companies will also be required to constitute an audit committee.

The 2017 Amendment Act also contains certain changes to the Audit Committee approval requirements for RPTs. Please refer the ‘Related party transactions’ section for more information on these changes.

Nomination and Remuneration Committee (NRC)

Similar to the Audit Committee constitution related change discussed above, the 2017 Amendment Act requires that instead of listed companies, only listed public companies and such other class of companies, as may be prescribed, should be required to constitute an NRC. Hence, a private company that has listed its debt instruments as per the SEBI Debt Listing Regulations will not be required to constitute an NRC.

In accordance with section 178(2) of the 2013 Act, the NRC was required to carry out evaluation of every director’s performance. The 2017 Amendment Act requires that instead of carrying out evaluation of every director’s performance, the NRC should specify a methodology for effective evaluation of performance of the board, its committees and individual directors. The evaluation could be carried out by either the board, the NRC or an independent external agency. The NRC will review the implementation and compliance of the evaluation system.

A proviso to section 178(4) of the 2013 Act prescribes that the remuneration policy should be disclosed in the board’s report. The 2017 Amendment Act requires such policy to be placed on the website of the company, if any. The salient features of the policy and any changes therein along with the web address of the policy, if any, will be disclosed in the board’s report.
Declaration and payment of dividend

Distributable profits
The 2013 Act permits a company to pay dividend from current year’s profits or from ‘free reserves’ (in case of inadequacy of current year’s profits). As mentioned in the ‘Free reserves’ heading of this publication, the definition of ‘free reserves’ excludes unrealised/notional gains arising on fair valuation or revaluation of assets and liabilities. However, the 2013 Act appears to permit payment of dividend out of current year’s profits without adjustment in respect of notional/unrealised gains.

Interim dividend
In accordance with section 123(3) of the 2013 Act, a company may declare interim dividend during any financial year out of the surplus in the P&L account and out of profits of the financial year in which such interim dividend is sought to be declared.

From a plain reading of the paragraph, it appears that the interim dividend for a particular financial year could only be declared before the close of financial year and not thereafter. For example, a company has 31 March year-end and its annual general meeting (AGM) for the year ended 31 March 2017 is held in September 2017. From a literal reading of the section, the company can declare interim dividend only till 31 March 2017 and not thereafter, say, in May or June 2017.

Further, the use of the words “out of the surplus in the P&L account and out of profits of the financial year” indicate that a company may declare interim dividend only if it has at least some profit for the current financial year. Consider the following two scenarios:

a) Company A has accumulated profit of INR100 million at the beginning of the financial year. It earned an additional profit of INR0.1 million during the first six months of the financial year. Its accumulated profit at the end of six months is INR100.1 million.

b) Company B has accumulated profit of INR101 million at the beginning of the financial year. It incurred a loss of INR0.9 million during the first six months of the financial year. Its accumulated profit at the end of six months is INR100.1 million.

There is no clarity as to how Ind AS adjustment recognised in P&L will impact distributable profits recognised in P&L. Under Ind AS, an infrastructure company accounting for service concession arrangement recognises significant revenue and margins upfront, though the cash is received in the form of toll revenue over the next several years. A prudent policy would be to not distribute the accounting profits that will be realised over several future years. However, in the absence of clear legislation, this may not be enforceable.

The MCA may consider addressing these issues appropriately. In any case, the audit committee and board of companies applying Ind AS should ensure that prudent policies are followed for dividend distribution.

A company can declare interim dividend during any financial year or at any time during the period from the closure of financial year till holding of the AGM. Also, interim dividend can be declared out of surplus in the P&L account or out of profits for the financial year for which interim dividend is being declared.
Since Company A has earned a profit in the first six months, it can declare an interim dividend out of the accumulated profits of INR100.1 million. However, Company B with the same amount of accumulated profits cannot declare a dividend since it has incurred losses in the first six months.

The Companies Law Committee expressed the view that the above cannot be the intention of the law. To resolve the above issues, the 2017 Amendment Act allows declaration of interim dividend during any financial year or at any time during the period from the closure of financial year till the holding of the AGM. It also clarifies that interim dividend can be declared out of surplus in the P&L account or out of profits for the financial year for which interim dividend is sought to be declared or out of profits generated in the financial year till the quarter preceding the date of declaration of the interim dividend. However, if a company has incurred losses during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, the rate of interim dividend cannot be higher than the average dividends declared by the company during the immediately preceding three financial years.

Final dividend

The second proviso of Section 123 (1) of the Act states as below:

“Provided that where, owing to inadequacy or absence of profits in any financial year, any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by it to the reserves, such declaration of dividend shall not be made except in accordance with such rules as may be prescribed in this behalf.”

The wordings used in the 2013 Act suggest that compliance with the Companies (Declaration and Payment of Dividend) Rules, 2014 will be required only when dividend is declared out of amounts already transferred to ‘reserves’. However, in contrast, rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014 allows companies to declare dividend out of ‘free reserves’ only if the conditions laid in the rule have been complied with (Emphasis added). Since ‘surplus in the profit and loss account’ is also a free reserve, it is not clear whether a company will be required to comply with the said rules even when it declares dividend out of surplus in the P&L account. The surplus balance (i.e., carried forward balance of the P&L account) is a part of ‘free reserves’ but it does not represent an amount ‘transferred’ to reserves.

Companies will have freedom of utilising the balance standing in the P&L account (and not transferred to the reserves) for payment of dividend. Appropriate change can be made in Dividend Rules to clarify this further.

The Companies Law Committee discussed the issue and was of the view that companies must have the freedom of utilising the balance standing in the P&L account (and not transferred to the reserves) for payment of dividend in case of inadequacy of profit in a year. The Committee was of the view that once rule 3 is aligned with the provisions of the 2013 Act, this aspect will be clear. The Committee suggested that to avoid any legal challenges in application, the requirements of the Rule and the section should be harmonised appropriately.

The 2017 Amendment Act does not contain any change on this matter. It is important that the Government make appropriate changes in the rules to align the same with the requirements of the 2013 Act. Also, it appears that companies will have freedom of utilising the balance standing in the P&L account (and not transferred to the reserves) for payment of dividend in case of inadequacy of profit in a year. Specifically they will not be required to comply with the Companies (Declaration and Payment of Dividend) Rules, 2014 in such cases.
Uniform financial year

Section 2 (41) of the 2013 Act required companies, except specified International Financial Services Centre (IFSC) companies, to adopt a uniform accounting year ending 31 March. Companies that were following a different financial year at the time of enactment were required to align their financial year with the new requirement within two years. However, a proviso to the definition states that a company may apply to the National Company Law Tribunal (Tribunal/NCLT) for adoption of a different financial year if it satisfies the following two criteria:

a) It is a holding or subsidiary of a company incorporated outside India.

b) It is required to follow a different financial year for consolidation of its financial statement outside India.

It was observed that companies which are associates or joint ventures of a company incorporated outside India did not have right to approach the NCLT for adopting a different financial year-end, though their financial statements were also taken into consideration in the preparation of CFS outside India.

The 2017 Amendment Act addresses this issue by allowing associates of a company incorporated outside India to apply to the NCLT for adoption of a different financial year. In accordance with section 2(6) of 2013 Act, the term ‘associate’ includes joint ventures also. Hence, the relief will apply to joint ventures also.

The Central Government has constituted the NCLT under the Act from 1 June 2016. Pending constitution of the NCLT by the Government, many companies which are subsidiaries of the company incorporated outside India had previously approached the Company Law Board (CLB) and received permission to adopt a different financial year. We believe that considering changes made by the 2017 Amendment Act, companies which are associates or joint ventures of a company incorporated outside India can now approach the NCLT for adoption of a different financial year.

Consolidated financial statements

Section 129(3) of the 2013 Act requires that a company having one or more subsidiaries will, in addition to separate financial statements, prepare CFS. An explanation to section 129(3) of the 2013 Act stated, “For the purpose of this sub-section, the word subsidiary includes associate company and joint venture.” The meaning of this explanation was not very clear, leading to the possibility of different views. However, it was generally understood that the explanation required CFS to be prepared when the company had an associate or joint venture, even though it did not have any subsidiary. The associate and joint venture were accounted for using the equity/proportionate consolidation method in the CFS.

To address this issue and bring out the intention clearly, the 2017 Amendment Act has deleted the above stated explanation. Rather, it is stated that a company having one or more subsidiary or associate company will, in addition to separate financial statements, prepare CFS. Since the term ‘associate company’ includes ‘joint venture companies’, a company having joint ventures will also need to prepare CFS even if it does not have any subsidiary. The CFS will be prepared as per the applicable accounting standards.

We believe that this is a clarificatory change and should not have any major impact vis-à-vis practices currently followed.

Companies which are associates or joint ventures of a company incorporated outside India can now approach the NCLT for adoption of a different financial year.
CEO to sign financial statements

In accordance with section 134(1) of the 2013 Act, the CEO is required to sign the financial statement including CFS only if he or she is a director in the company. In contrast, the CFO and the Company Secretary of the company are always required to sign the financial statements. The Companies Law Committee observed that in case of a company not having a managing director, the CEO is a KMP and responsible for the overall management of the company. Hence, the CEO should be mandated to sign the financial statements, irrespective of whether he or she is a director or not. The 2017 Amendment Act amends section 134(1) to this effect.

Subsidiary financial statements

A proviso to section 136(1) of the 2013 Act requires every company having one or more subsidiaries to:

a) Place separate audited accounts in respect of each of its subsidiary on its website, if any
b) Provide a copy of separate audited financial statements in respect of each of its subsidiary, to a shareholder who asks for it.

These requirements have given rise to certain interpretation issues such as whether the financial statements of a foreign subsidiary need to be prepared as per accounting standards applicable in India (Indian GAAP/Ind AS) or financial statements prepared as per the local GAAP of the country of incorporation of the foreign subsidiary would be sufficient. Also, whether a company can place/file unaudited financial statements of a foreign subsidiary or audit is mandatory, particularly if the audit of such foreign subsidiary is not mandatory in the country where such foreign subsidiary has been incorporated and such audit has not been conducted. The MCA clarified vide General Circular 11/2015 dated 21 July 2015 that in case of a foreign subsidiary which is not required to get its accounts audited as per legal requirements prevalent in the country of its incorporation and which does not get such accounts audited, the holding/parent Indian company may place/file such unaudited accounts to comply with requirements of sections 136(1) and 137(1) as applicable. These financial statements, however, would need to be translated in English if the original accounts are not in English. Further, the format of accounts of foreign subsidiaries should be, as far as possible, in accordance with requirements under the 2013 Act. If this is not possible, a statement indicating the reasons for deviation may be placed/filed along with such accounts.

Internal financial control reporting

In accordance with section 134(5)(e) of the 2013 Act, the Director’s Responsibility Statement should, amongst other matters, state that the directors of a listed company had laid down the internal financial controls to be followed by the company and that such controls were adequate and operating effectively. The Companies Law Committee received certain suggestions stating that IDs were facing difficulties in certifying that the directors had laid down the internal financial controls to be followed by the company and that it should be sufficient for the managing/executive directors to confirm that the company had a mechanism in place for internal financial controls. However, the Committee observed that it was essential to cast this responsibility on the entire board in consonance with the fiduciary responsibilities bestowed on directors under the 2013 Act. Hence, the 2017 Amendment Act does not contain any change on this matter.

Only listed companies will be required to place subsidiary financial statements on their website, if any. This requirement will not apply to non-listed companies. However, both listed and non-listed companies will be required to provide subsidiary financial statements to a member of the company who asks for it.

CEO will be required to sign the financial statements even if he or she is not a director in the company.
The 2017 Amendment Act contains the following key changes/clarifications in this regard:

a) Only listed companies having a subsidiary or subsidiaries will be required to place separate audited accounts in respect of each of subsidiary on their website, if any. This requirement will not apply to non-listed companies.

b) If a listed company has a foreign subsidiary and such foreign subsidiary is statutorily required to prepare CFS under any law of the country of its incorporation, the requirement for placing financial statements on the website will be met if the CFS of such foreign subsidiary are placed on the website of the listed company. Apparently, there is no requirement to host separate financial statements for step-down subsidiaries on the website.

c) If a listed company has a foreign subsidiary and such foreign subsidiary is not required to get its financial statement audited under any law of the country of its incorporation and which does not get such financial statement audited, the holding Indian listed company may place unaudited financial statement for the concerned foreign subsidiaries on its website. Where such financial statements are in a language other than English, a translated copy of the financial statement in English will also be placed on the website.

d) Both listed and non-listed companies having a subsidiary or subsidiaries will be required to provide a copy of separate audited or unaudited financial statements, as the case may be, as prepared in respect of each of its subsidiary to any member of the company who asks for it. Apparently, this clause does not give companies an option of giving only CFS of foreign subsidiaries having further step-down subsidiaries. This suggests that if a foreign subsidiary has step-down subsidiaries and members asks for separate financial statements of those step-down subsidiaries, the company will be required to provide them.

In accordance with the fourth proviso to section 137(1), a company will, along with its financial statements to be filed with the Registrar, attach the accounts of its subsidiary or subsidiaries that have been incorporated outside India and have not established their place of business in India. The 2017 Amendment Act states that if a subsidiary incorporated outside India is not required to get its financial statement audited under any law of the country of its incorporation and which does not get such financial statement audited, Indian holding company may file such unaudited financial statements with the Registrar along with a declaration to this effect.

Where such financial statements are separately presented in a language other than English, a translated copy of the financial statements in English will also be filed. We believe these changes will address many practical issues faced by companies.

Right of member to copies of audited financial statement

Section 101 of the 2013 Act requires a 21-day notice to call for a general meeting. It also allows a general meeting to be called for at a shorter notice if at least 95% of the voting power consents to such shorter notice. Section 136 of the 2013 Act requires annual accounts to be circulated to the members 21 days in advance. However, it does not provide for a shorter notice period to circulate the annual accounts. The MCA had issued a circular dated 21 July 2015, which clarified that the shorter notice period would also apply to the circulation of annual accounts. However, there was a concern as to whether the general circular can override the requirements of the 2013 Act.

To address this concern, the 2017 Amendment Act amends section 136. In accordance with the amendment, companies will be allowed to circulate financial statements at a shorter notice if it is so agreed by 95% of the members entitled to vote at the meeting.
Re-opening of accounts on court’s or Tribunal’s orders

Section 130 of the 2013 Act provides for the re-opening of accounts on order from a court or a Tribunal. The proviso to section 130(1) provides that the court or the Tribunal will give a notice to the Central Government, the income-tax authorities, SEBI or any other statutory regulatory body or authority concerned and will take into consideration any representations made by them before passing any order under the section. For giving other concerned parties, such as a company or the auditor/Chartered Accountant of the company, an opportunity to present their point of view, the 2017 Amendment Act states that in addition to authorities already specified, any other person concerned will also be given notice for presenting views before passing an order for re-opening of accounts.

Currently, section 130 of the 2013 Act does not specify any limit on the period for which the accounts could be re-opened. The Companies Law Committee was of the view that it would be a significant burden on companies if they are required to maintain their accounts forever, or beyond a reasonable time limit, because of section 130. Hence, the 2017 Amendment Act states that order for reopening of accounts can be made up to eight financial years immediately preceding the current financial year unless there is a specific direction under section 128(5) from the Central Government for maintaining accounts for a longer period. This will ensure that requirements related to re-opening of accounts are aligned with the requirements related to maintenance/preservation of books of account by companies.

Financial information to be included in the prospectus

In the case of an initial public offer (IPO), section 26(1)(b) requires the offer document to include, amongst other matters, reports relating to profits and losses for each of the five financial years immediately preceding the financial year of the issue of prospectus. Globally, including in the US, companies are typically required to disclose three-year financial information in the case of a listing. Hence, the requirements in India are excessive vis-à-vis the other parts of the world.

The Companies Law Committee noted that SEBI was in the process of simplifying the contents of the prospectus/offer document by amending the provisions of the SEBI (ICDR) Regulations, 2009 so as to reduce the volume of disclosures. SEBI has undertaken this exercise to address suggestions received from the stakeholders that those offer documents are becoming too long, too detailed, repetitive and difficult to understand. However, this objective could be achieved only if section 26(1) of the 2013 Act is modified to empower SEBI to prescribe the contents in consultation with MCA.

Considering the above and based on the suggestions of the Companies Law Committee, the 2017 Amendment Act amends section 26(1). The amended section 26(1) states that the contents of the prospectus with respect to financial information and reports on financial information will be specified by SEBI in consultation with the Central Government. Until SEBI specifies the information and reports on financial information under this sub-section, the regulations made by SEBI under the SEBI Act in respect of such financial information or reports on financial information will apply.

We welcome the change. We recommend that in line with the global practice, SEBI should require three-year financial information.
Audit and auditors

Appointment of auditors

In accordance with section 139(1) of the 2013 Act, the auditor of a company is appointed by the shareholders at the AGM, for a consecutive period of five years. However, the appointment needs to be ratified each year at the AGM. The 2013 Act was silent on the implications of non-ratification of the auditor appointment at the AGM. In the absence of clarity, the following two views were possible:

a) If shareholders do not ratify the appointment of the auditor at the AGM, it would tantamount to removal of the auditor from the office. This in turn will empower the board to appoint another individual or firm as the auditor of the company in place of the outgoing auditor followed by approval through an ordinary resolution at the EGM.

b) Section 140(1) of the 2013 Act requires that the auditor appointed under section 139 can be removed from its office before the expiry of term only by passing a special resolution of the company at the AGM and after obtaining previous approval from the Central Government. Thus, if shareholders do not ratify the auditor appointment at the AGM, it would trigger section 140(1) of the 2013 Act requiring the company to pass a special resolution of the AGM and take the Central Government’s approval for removing the auditor from office before completion of the term.

The Companies (Audit and Auditors) Rules, 2014 supported view (a). An explanation to rule 3(7) stated that “if the appointment is not ratified by the members of the company, the board of directors shall appoint another individual or firm as its auditor or auditors after following the procedure laid down in this behalf under the Act.”

There will be no requirement for annual ratification of auditor’s appointment at the AGM. This change is supportive of auditor independence.

Eligibility, qualifications and disqualifications of auditors

Definition of relative

Section 141(3)(d) of the 2013 Act, amongst other matters, provides that a person will not be eligible for appointment as an auditor of a company if that person, or his or her relative or partner, holds any security or gives a guarantee or is indebted to the company for specified amounts, etc. In accordance with section 2(77) of the 2013 Act read with the rules, ‘relatives’ comprise members of HUF, husband and wife, father (including step-father), mother (including step-mother), son (including step-son), son’s wife, daughter, daughter’s husband, brother (including step-brother) and sister (including step-sister).

There is a genuine concern that bringing relatives into the determination of the criteria for qualifications and disqualifications of auditors would have significant repercussions on ensuring compliance. Even if any of these relatives of the
Companies Amendment Act 2017: an overview of key changes

Despite recommendations of the Companies Law Committee and the Standing Committee, the 2017 Amendment Act does not contain any change in definition of the term ‘relative’ for auditors’ independence. This implies that the original definition in the 2013 Act and related rules will continue to apply for auditors’ independence, resulting in various challenges mentioned above. We recommend that to address these challenges and in line with the recommendations of the Companies Law Committee and the Standing Committee, ‘relative’ for auditors’ independence should be defined as the spouse or a dependent relative of the person. For this purpose, the ‘dependent’ should be a person who has received more than half of their financial support for the most recent financial year from the auditor.

Independence/Prohibited services

Section 141(3)(i) of the 2013 Act provides that any person whose subsidiary, associate company or any other form of entity is engaged, on the date of appointment, in rendering services prohibited under section 144 will be disqualified from being appointed as an auditor.

The language used in the above section is ambiguous. It may be argued that an individual or firm could not be appointed as an auditor of any company in India if the individual/firm, its subsidiary or associate company is engaged in any of the activities mentioned in section 144 of the 2013 Act with any entity whether auditee or not and anywhere in the world. For disqualification under this clause, it does not matter whether the individual/firm, its subsidiary or associate company was rendering these service only to an entity that is totally unconnected with the auditee company. In other words, the audit firm can either engage in rendering audit services or services mentioned in section 144. The same firm cannot render these services even to two different companies that are completely independent from each other. This would have acted as a significant deterrent to the development of multi-disciplinary firms in India and was not the intention of the 2013 Act.

An audit firm cannot render prohibited services directly or indirectly to the company, its holding company or its subsidiary company which proposes to appoint the auditor. There will be no restriction on rendering these services to other companies.
The 2017 Amendment Act amends the language of section 141(3)(i) to clarify that the restriction would apply only if the services were directly or indirectly rendered to the company, its holding company or its subsidiary company which proposes to appoint the auditor. In our view, this is more of a clarificatory change. We welcome this clarification.

Right to access the accounts and records of a joint venture/associate company

In accordance with the first proviso to section 143(1) of the 2013 Act, the auditor of a holding company will also have the right to access the books of accounts of subsidiary companies in connection with the consolidation of accounts. However, the auditor of the holding company did not have a right of access to accounts and records of a joint venture/associate company, though their accounts are also required for preparation/audit of CFS.

The 2017 Amendment Act addresses this issue by amending the first proviso to section 143(1). In accordance with the amendment, the auditor of a holding company will have a right of access to the accounts and records of the associate company and joint venture company in addition to the accounts and records of the subsidiary company whose accounts are required to be consolidated.

The auditor of a holding company will have a right of access to the accounts and records of the associate and joint venture companies, in addition to the accounts and records of the subsidiary companies.

Amongst other matters, the auditor of the parent company needs to express an opinion on true and fair view of the separate financial statements as well as CFS of the parent. The auditor also needs to express an opinion on whether these financial statements comply with the applicable accounting standards. In a scenario where the auditor of the parent company is not an auditor of all its subsidiary, associate and joint venture companies, then the subsidiary, associate and joint venture companies of the group are likely to be audited by other auditors and the auditor of the parent company will receive audited financial statements for these subsidiary, associate and joint venture companies. In majority cases, the auditor of the parent company should be able to express an opinion on the CFS of the parent using audited financial statements of subsidiary, associate and joint venture companies and there should be no need to refer underlying books of account. However, in some cases, Standard on Auditing (SA) 600, Using the Work of Another Auditor, may require the parent company auditor to obtain an additional comfort/perform additional procedures on financial information of subsidiary, associate and joint venture companies for being able to express a true and fair opinion on the CFS of the parent. Changes made in the 2017 Amendment Act will help auditors to deal with these scenarios in a more appropriate manner.

Reporting on internal financial controls

Section 143(3) of the 2013 Act states that the auditor’s report, amongst other matters, will state “whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls.” This requirement is applicable to all companies, including non-listed public and private companies. Neither the 2013 Act nor the audit rules define the term ‘internal financial controls’ for this purpose. In the 2013 Act, the meaning of the term ‘internal financial controls’ is given only in an explanation to section 134(5)(e) dealing with directors’ reporting responsibilities in case of listed companies. The said explanation lays down very wide responsibilities regarding internal financial control, which includes both financial reporting controls and business controls.

In the absence of any clarification in the 2013 Act, one possible view was that the explanation in section 134(5)(e) is relevant for deciding the auditors’ reporting responsibility as well. Hence, the auditor is responsible for reporting on both financial reporting controls and business controls. However, to address this concern, the Guidance Note on Audit of Internal Financial Controls over Financial Reporting issued by the ICAI has clarified that the
National Financial Reporting Authority (NFRA)

Section 132 of the 2013 Act empowers the Central Government to constitute the NFRA. The NFRA will be a quasi-judicial body and will have the responsibility to ensure overall quality of financial reporting. In addition to advising the Central Government on formulation of accounting standards for adoption by companies/class of companies, the NFRA will:

a) Make recommendations to the Central Government on formulation and laying down of auditing policies and standards for adoption by auditors

b) Monitor and enforce compliance with accounting and auditing standards in the manner as may be prescribed

c) Oversee the quality of service of professionals associated with ensuring compliance with standards, and suggest measures required for improvement in quality and such other related matters as may be prescribed, and

d) Perform other prescribed functions.

Till the time of this publication, the Government had not constituted the NFRA. In the context of the NFRA, ICAI and some other stakeholders have pointed out that ICAI is already discharging regulatory functions related to discipline. Hence, there was a concern that constitution of the NFRA will result in multiple layers of regulation and duplication of work. To address these concerns, these stakeholders have proposed that section 132 should be deleted.

The Companies Law Committee deliberated this issue in detail. The Committee was of the view that there was a need for an independent body to oversee the profession. Major economies of the world have already established such regulatory bodies. The Committee by a majority view recommended that section 132 should continue to exist and the NFRA should be established early. Consultation may, however, be carried out with the ICAI with regard to the jurisdiction of the NFRA and ICAI representation on the NFRA.

The Standing Committee on Finance had a different view on the matter. The Standing Committee desired that the existing mechanism under the ICAI Act should be streamlined and strengthened without needlessly adding to regulatory levels. This may be undertaken in consultations with the ICAI. If needed, amendments to the ICAI Act may be brought before the Parliament so that adequate transparency can be ensured in maintaining accounting and auditing norms as well as ethical standards.

The 2017 Amendment Act does not omit section 132.

Auditors’ responsibility for reporting on internal financial controls will be limited to financial statements. They will not be required to report on the business controls.
Penalty on auditors

Criminal liability

Section 147(5) of the 2013 Act provides that where an audit is conducted by an audit firm, and it is proved that the partner or partners of the audit firm have acted in a fraudulent manner or abetted or colluded in any fraud, the liability, whether civil or criminal for such action, will be of the partner or partners concerned of the audit firm and of the firm jointly and severally. However, rule 9 of the Companies (Audit and Auditors) Rules, 2014, provides that in case of criminal liability, the liability other than fine will devolve only on the concerned partners who acted in a fraudulent manner or abetted or colluded in any fraud. In other words, partners who have not acted in a fraudulent manner or abetted or colluded in any fraud will not have any criminal liability except fine.

There was a concern that the rules have effectively amended specific requirements of the 2013 Act related to joint and several liability. Hence, it may have potentially resulted in a scenario where the rules were overriding specific requirements of the 2013 Act. To address these concerns, the 2017 Amendment Act has included provisions of rule 9 in the Act itself.

Liability to ‘any other person’

Under sub-section (2) of section 147 of the Act, if an auditor of a company contravenes any of the provisions of the specified sections therein, he or she shall be punishable with a fine not less than INR25,000 but which may extend to INR5 lakh. However, as per the proviso, if the contravention by the auditor is done knowingly or willfully with an intention to deceive the company or its shareholders or creditors or tax authorities, the penalty is significantly enhanced to imprisonment for a term that may extend to one year and with fine not less than INR1 lakh but which may extend to INR25 lakh.

Additionally, under sub-section (3), where an auditor has been convicted under sub-section (2), the auditor will be liable to refund the remuneration received by him or her and pay for damages to the company, statutory bodies or authorities or to any other person for loss arising out of incorrect or misleading statements of particulars made in the audit report. [Caparo Industries plc v/s Dickman & Others].

The 2013 Act has not defined the term ‘any other person.’ Thus, it was noted that the term ‘any other person’ in sub-section (3) may result in an unintended inclusion of a number of parties who may want to enforce a claim on the auditor without sufficient locus standi or cause. The accepted view even in advanced countries such as the UK is that the auditor would be liable only to a reasonable, limited and identifiable group of users that have relied on his or her work (e.g., creditors) even though these persons were not specifically known to the auditor at the time the work was done.

The 2017 Amendment Act has deleted the word ‘any other person’ in section 147(3)(ii). In any case, provisions in section 245(1)(g)(ii) relating to class actions are available as a remedy to an aggrieved group of persons. Hence, there is no need for reference to ‘any other person’ in section 147(3)(ii).

The 2017 Amendment Act has deleted the word ‘any other person’ in section 147(3)(ii). In place of these words, the words ‘members or creditors of the company’ have been inserted in sub-section (3) who are clearly identifiable parties and rely on the work of auditor. We welcome the change.
Board report

The Companies Law Committee received several suggestions pointing out that due to numerous disclosures required in the board report under section 134(3) of the 2013 Act, the report has become lengthier and more expensive to produce. The Committee expressed a view that there was a need to fine-tune the current requirements, without reducing the information content of the report. For example, salient points of the CSR policy and remuneration policy may be included in the report with a web address or link to detailed documents/policies. However, any change in the policies should be specifically highlighted in the salient points. Disclosures with regard to loans or investments under section 186 and particulars of contracts with related parties under section 188, if provided in the financial statements, may be only referred, and salient points discussed, in the board report. The 2017 Amendment Act provides for appropriate change in section 134(3) to give effect to the views of the Committee.

Also, section 92(3) of the 2013 Act has mandated the filing of an extract of the annual return as part of the board’s report. This requirement was leading to duplication of information being reported to the shareholders. To avoid duplication, the 2017 Amendment Act states that instead of filing an extract of the annual return, the web address/link of the annual return filed by the company and hosted on its website, if any, should be provided in the board report.

Residence requirement for Directors

Section 149(3) of the 2013 Act requires a company to have at least one director who has stayed in India for a total period of not less than 182 days in the previous calendar year. Based on the recommendations of the Companies Law Committee, the 2017 Amendment Act states that the requirement of 182 days’ stay in India will be computed based on the financial year instead of the calendar year. It also states that the requirement will be for 182 days’ stay in India in the current financial year and not the previous financial year. Also, in the case of newly incorporated companies, this requirement will apply proportionately at the end of the financial year.

Companies will need to plan in advance so that they are compliant with this requirement at the end of the financial year. In some cases, they may even need to enter into an arrangement with one or more directors so that they stay in India for a minimum 182 days in the financial year.

Disqualifications for appointment of director

In accordance with section 164(2) of the 2013 Act, a person who is or has been a director of the following company becomes disqualified for re-appointment as a director of that company or appointment in any other company for a period of five years from the date of disqualification.

a) Company which has not filed financial statements or annual returns for a continuous period of three financial years
b) Company which has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more.

Section 167(1)(a) of the 2013 Act provides that if a person incurs any disqualification under section 164(2), the person’s office of director becomes immediately vacant in all companies where the person is a director. One of the consequences of section 167(1)(a) is that for the company which has committed default under 164(2), the office of all the directors on the board would become vacant. This could create significant challenges. Also, a new person cannot be appointed as a director as they will also attract such a disqualification.

To avoid this situation, the 2017 Amendment Act clarifies that if a person incurs disqualification under section 164(2), the office of the director will become vacant in all companies except the company which is in default under section 164(2). The 2017 Amendment Act also states that when a person is appointed as a director of a company which has already defaulted under one or both of the above clauses, then such director will not incur disqualification for a period of six months from the date of appointment.
Limit on managerial remuneration

Section 197(1) of the 2013 Act prescribes that total managerial remuneration payable by a public company should not exceed 11% of the net profits of that company. However, such limits may be exceeded with the approval of the shareholders and the Central Government.

The second proviso to section 197(1) of the 2013 Act prescribes the following limits on remuneration payable to each managerial personnel/director and total remuneration payable to them. The company can exceed these limits only by passing an ordinary resolution at the general meeting:

(i) The remuneration payable to any one managing director, or whole-time director or manager will not exceed 5% of the net profits of the company. If there is more than one such director, then remuneration will not exceed 10% of the net profits to all such directors and managers taken together.

(ii) The remuneration payable to directors who are neither managing directors nor whole-time directors will not exceed:

a) 1% of the net profits of the company, if there is a managing or whole-time director or manager

b) 3% of the net profits, in any other case

Currently, the laws in countries such as the US, the UK and Switzerland do not require a company to approach government authorities for approving remuneration payable to their managerial personnel, even in a scenario where the company has losses or inadequate profits. Rather, the board/shareholders of the company are typically empowered to decide on remuneration payable to directors. In line with the global practices, the 2017 Amendment Act removes the requirement for the Central Government approval for paying remuneration exceeding 11% of the net profits of the company. Rather, it requires the following:

a) Where the company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, as the case may be, will be obtained by the company before obtaining the approval in the general meeting.

b) For exceeding the limits of remuneration payable to each managerial personnel/director and total remuneration payable, which are prescribed in the second proviso to section 197(1), a company will need to pass a special resolution instead of an ordinary resolution at the shareholders’ meeting.

We welcome the changes made in the 2017 Amendment Act as they will bring requirements related to managerial remuneration more in line with those prevalent in developed economies such as the US, the UK and Switzerland and also provide flexibility to companies in deciding managerial remuneration. To avoid potential misuse and address potential concerns related to payment of excessive remuneration, the 2017 Amendment Act has incorporated adequate safeguards in the form of special resolution at the shareholder’s meeting and prior approval of lenders whose dues have not been paid on time. Since these parties will be significantly impacted by the payment of excessive remuneration, they will be much better placed to evaluate the financial position/performance of the company and approve managerial remuneration justified in the scenario.

Calculation of profits for managerial remuneration

Section 198(3)(a) of the 2013 Act requires a company to exclude profits from sale of investment for calculation of profits for managerial remuneration. The 2017 Amendment Act clarifies that the profit on sale of investment will not be excluded for investment entities since that is their principal business activity.

Section 198(4) of the 2013 Act requires that whilst calculating net profit for computing managerial remuneration, ‘brought forward losses’ of any year, which begins on or after the commencement of the 2013 Act, be reduced. However, the section did not provide for the deduction of brought forward losses of the years prior to the commencement of the 2013 Act. The 2017 Amendment Act addresses this issue by also requiring deduction of brought forward losses relating to any year insofar as such losses have not been deducted in any subsequent year.
Managerial remuneration in case of absence/ inadequacy of profits

Section 197(3) provides as below:

“Notwithstanding anything contained in sub-sections (1) and (2), but subject to the provisions of Schedule V, if, in any financial year, a company has no profits or its profits are inadequate, the company shall not pay to its directors, including any managing or whole-time director or manager, by way of remuneration any sum exclusive of any fees payable to directors under sub-section (5) hereunder except in accordance with the provisions of Schedule V and if it is not able to comply with such provisions, with the previous approval of the Central Government.”

In accordance with the section, if a company has no profit or inadequate profits, the company will not pay remuneration (excluding any sitting fees or other fees decided by the board) to its directors except in accordance with Schedule V. Based on the effective capital, Schedule V prescribes a limit on yearly managerial remuneration. The company can double these limits by passing a special resolution at the shareholders’ meeting. If the company is not able to comply with these requirements, prior approval of the Central Government is required.

The 2017 Amendment Act deletes the words “and if it is not able to comply with such provisions, with the previous approval of the Central Government” from section 197(3). However, the 2017 Amendment Act does not contain changes to Schedule V. They may be notified at a later date.

Based on our understanding, the reason for deletion in section 197(3) is that the Central Government has been excluded from matters related to approval of managerial remuneration. However, since changes to Schedule V are not included in the 2017 Amendment Act, the implications of the change are not clear. Based on future changes to Schedule V, the following implications may be possible:

a) The company cannot pay remuneration exceeding limits prescribed in Schedule V. As permitted by Schedule V, these limits can be doubled by passing a special resolution at the shareholders’ meeting. However, no further increase in remuneration is possible.

b) The company can pay remuneration exceeding limits prescribed in Schedule V if it follows the prescribed procedures. The procedure to be followed may be prescribed in Schedule V or rules to be notified at a later stage.

c) Whilst the reference to the Central Government approval has been removed from section 197(3), Schedule V still contains reference to such approval for paying higher remuneration. Hence, if the MCA does not make changes to Schedule V, the company can continue paying higher remuneration only after taking the Central Government approval.

In our view, this aspect should be clarified by making appropriate changes to Schedule V/rules.

Refund of excess remuneration

Section 197(9) of the 2013 Act provides that if any director draws or receives, directly or indirectly, any remuneration exceeding the prescribed limit, then he or she will refund such excess remuneration to the company. Until such sum is refunded, the director will hold excess remuneration in trust for the company. However, the 2013 Act was silent on the time limit within which the money needs to be refunded.

The 2017 Amendment Act addresses this gap and prescribes the time limit for repayment of excess remuneration drawn by a director. It states that the director will refund the excess remuneration within two years or such lesser period as may be prescribed by the company.

Auditor reporting

The 2017 Amendment Act introduces a requirement for auditor’s reporting on the managerial remuneration. It requires that the auditor of the company, in its report under section 143, will make a statement as to whether the remuneration paid by the company to its directors is in accordance with the provisions of this section, i.e., section 197, and whether remuneration paid to any director is in excess of the limit laid down under this section and give such other details as may be prescribed.

Currently, the Companies (Auditor’s Report) Order, 2015 requires that an auditor, amongst other matters, should report on the following:

“(xi) Whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with Schedule V to the Companies Act? If not, state the amount involved and steps taken by the company for securing refund of the same.”

Hence, the 2017 Amendment Act has resulted in duplication of reporting with the auditor’s reporting already required under the Companies (Auditor’s Report) Order, 2015. We recommend that MCA may address this by making changes to the Companies (Auditor’s Report) Order, 2015.
Acceptance of deposits by companies

Amount to be kept in a separate account

In accordance with sections 73(2Xc) and 73(5) of the 2013 Act, a company accepting deposits from its members or the public is required to deposit an amount not less than 15% of the amount of its deposits maturing during the current and the next financial year in a separate bank account with a scheduled bank. The said account is known as the deposit repayment reserve account and cannot be used by the company for any purpose other than the repayment of deposits. Private companies accepting deposits within the specified limits from their members are exempted from this requirement.

The Companies Law Committee observed that this provision was a safeguard for depositors. However, it increases the cost of borrowing for companies as well as it will lock up a high percentage of the borrowed sums.

Deposit insurance

Section 73(2Xd) mandates a company accepting deposits to provide for deposit insurance in the manner and extent as prescribed in the Companies (Acceptance of Deposits) Rules, 2014. However, since insurance companies do not offer any products for covering company deposit default risks, this requirement was relaxed by the MCA till 31 March 2018 or till the availability of a deposit insurance product, whichever is earlier (refer The Companies (Acceptance of Deposits) Amendment Rules, 2017 dated 11 May 2017). The MCA also took up this issue with the Department of Financial Services (DFS). The DFS stated that though an insurance company is not prevented by the IRDA from devising an insurance policy to cover default risks, it is difficult to assess the risk and its likely exposure to liability as companies are not as tightly regulated as banks with particular reference to their financial efficiency and fulfilment of commitments.

Considering the above scenario, the 2017 Amendment Act has omitted the said provisions of section 73(2Xd). We believe that to align with the 2017 Amendment Act, suitable changes will also be made in the relevant rules. We believe that this is a step in the right direction.

Impact of past defaults

To invite, accept or renew any deposits, section 73(2Xe) of the 2013 Act requires a certification from the company that no default has been committed either in the repayment of deposits or interest thereon, accepted either before or after the commencement of the 2013 Act. This requirement apparently covers all past defaults, without any time limit. The Companies Law Committee observed that this requirement was too harsh on companies which may have defaulted due to reasons beyond their control, such as industry conditions at some point of time in the past but have repaid such deposits with earnest efforts thereafter. Imposing a lifelong ban for a default anytime in the past would be inappropriate.

A company accepting deposit will be required to deposit and keep in a scheduled bank the amount which is not less than 20% of the amount of deposits maturing during the current financial year. There will be no need to deposit any amount in respect of deposits maturing in the next financial year.
If a company has made good an earlier default in repayment of deposits and interest thereon, then it will be allowed to accept further deposits after five years from the date of repayment. However, a full disclosure of past defaults will be required.

To address this challenge, the 2017 Amendment Act states that the prohibition on accepting further deposits would apply indefinitely only to a company that has not rectified/made good earlier defaults. However, if a company has made good an earlier default in repayment of deposits and interest due thereon, then it should be allowed to accept further deposits after a period of five years from the date it repaid the earlier defaulting amounts. However, a full disclosure of all past defaults will be required.

Repayment of deposits accepted before commencement of the Act

Section 74(1Xb) of the 2013 Act states that in respect of any deposit accepted by a company before the commencement of the Act, where the amount of such deposit or part thereof or any interest due thereon remains unpaid on such commencement or becomes due at any time thereafter, the company will repay it within one year from such commencement or from the date on which such payments are due, whichever is earlier.

Considering practical difficulties in early repayment, rule 19 in the Companies (Acceptance of Deposits) Rules, 2014 states that if a company which had accepted or invited public deposits under the relevant provisions of the Companies Act, 1956 and rules made under that Act (hereinafter known as ‘earlier deposits’) and has been repaying such deposits and interest thereon in accordance with such provisions, requirements of section 74(1) (b) of the 2013 Act will be deemed to have been complied with if the company complies with requirements under the 2013 Act and the rules made thereunder and continues to repay such deposits and interest due thereon on due dates for the remaining period of such deposit in accordance with the terms and conditions and period of such earlier deposits. In other words, there will be no need to make early repayment of the deposits as required by section 74(1Xb).

To align the two requirements and address concerns related to rules overriding the 2013 Act, the 2017 Amendment Act states that the amount of earlier deposits should be repaid within three years from the date of commencement of the Act or before the expiry of the period for which the deposit was accepted, whichever is earlier. The 2017 Amendment Act also requires that any renewal of earlier deposits should be done as per the requirement of the 2013 Act.
The provision of the 2013 Act concerning mergers, amalgamation and reconstruction of companies was notified recently and became applicable from 15 December 2016. Given below is an overview of its key requirements:

a) A company will file a scheme with the Tribunal for approval for (i) reduction in share capital, (ii) making a compromise/arrangement with creditors and members, and (iii) merger/amalgamation of companies.

b) Subject to the RBI approval, both inbound and outbound cross-border mergers and amalgamations between Indian and foreign companies are permitted. The Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 specify overseas jurisdictions where cross-border mergers and amalgamations are allowed.

c) An application can be made to the tribunal for making a compromise or arrangement involving CDR. Any such scheme should, amongst other matters, include:

(i) A report by the auditors of the company to the effect that its fund requirements after the CDR conforms to the liquidity test based on the estimates provided by the board of directors.

(ii) A valuation report in respect of the shares and the property and all assets, tangible and intangible, movable and immovable, of the company by a registered valuer.

d) The tribunal will not sanction a scheme of capital reduction, merger, acquisition or other arrangement unless the accounting treatment prescribed in the scheme is in compliance with the notified accounting standards (Ind AS or Indian GAAP, as applicable to the company) and a certificate to that effect by the company’s auditor has been filed with the Tribunal. Hence, compliance with the accounting standards is mandatory for all companies.

e) A transferee company cannot hold any shares in its own name or in the name of a trust either on its behalf or on behalf of its subsidiary/associate companies. The 2013 Act requires such shares to be cancelled or extinguished. This prohibits the creation of any treasury shares under the scheme.

f) In case of merger/amalgamation of companies, the following documents should also be circulated for the meeting proposed between the company and concerned persons:

(i) Report of the expert on valuation, if any

(ii) Supplementary accounting statement if the last annual financial statements of any of the merging companies relate to a financial year ending more than six months before the first meeting of the company summoned for approving the scheme.

g) The merger of a listed company into a non-listed company will not automatically result in the listing of the transferee company.

h) Only persons holding not less than 10% of the shareholding or having outstanding debt not less than 5% of total outstanding debt can raise objections to the scheme.

The 2017 Amendment Act contains a small language change related to amalgamation. Since the term ‘transferor company’ is not defined, it replaces these words with the words ‘company whose shares are being transferred.’ This is only a language change and will not have any significant implications.
**Practical perspective**

The applicability of provisions of the 2013 Act concerning mergers, amalgamation and reconstruction to Ind AS companies results in a practical issue. Given below is an overview of the issue and our perspective:

**Appointed date vs. effective date**

Section 232(6) of the 2013 Act, *inter alia*, requires the merger/amalgamation scheme to clearly indicate an appointed date from which it will be effective. It states that the scheme will be deemed to be effective from such date and not at a date subsequent to the appointed date.

Based on this, all merger and acquisition schemes requiring Tribunal approval have an appointed date mentioned in the scheme, which is generally a retrospective date. The scheme generally becomes effective when the Tribunal order is passed and the order is filed with the Registrar of Companies. The appointed date is a very important date because from an income-tax legislation perspective, that is the date when the amalgamation or acquisition accounting is done and the carry forward of any business losses is allowed to the transferee.

Indian GAAP accounting is aligned to the appointed date concept. AS 14 *Accounting for Amalgamations* does not expressly contain any discussion around the difference between the appointed date and the effective date. However, an EAC opinion* required the accounting of the combination from the appointed date mentioned in the court scheme once the court approval was received. From an income-tax perspective, the company would need to file revised returns to reflect the combination from the appointed date.

Ind AS does not recognise the Indian GAAP position and/or appointed date concept. Ind AS 103 *Business Combinations* prescribes significantly different accounting for business combinations which are not under common control and those under common control. Amongst other matters, it contains specific guidance on the date from which business combinations should be accounted for. For business combinations not under common control, paragraphs 8 and 9 of Ind AS 103 state as below:

**“Determining the acquisition date**

8. The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree.

9. The date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree—the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date. For example, the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date. An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date.”

For business combinations under common control, paragraphs 8 and 9 of Appendix C to Ind AS 103 state as below:

“8. Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interests method.

9. The pooling of interest method is considered to involve the following:

(i) The assets and liabilities of the combining entities are reflected at their carrying amounts.

(ii) No adjustments are made to reflect fair values, or recognise any new assets or liabilities. The only adjustments that are made are to harmonise accounting policies.

(iii) The financial information in the financial statements in respect of prior periods should be restated as if the business combination had occurred from the beginning of the preceding period in the financial statements, irrespective of the actual date of the combination. However, if business combination had occurred after that date, the prior period information shall be restated only from that date (Emphasis added).”

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* The Expert Advisory Committee(EAC) opinion no. 14, volume. 32, on the subject ‘Accounting for amalgamation after the balance sheet date’ finalised on 31 July, 2012.
Mergers, amalgamation and reconstruction

When a business combination is effected after the balance sheet but before the approval of the financial statements for issue by either party to the business combination, a disclosure is made in accordance with Ind AS 10 Events after the Reporting Period but the business combination is not incorporated in the financial statements.

In both the scenarios, business combination accounting under Ind AS 103 should be done on the date on which the control is actually obtained, which is generally the date on which the Tribunal approval is received, if that happens to be last of the important formality. For example, in addition to the Tribunal approval, a merger scheme may require an approval from the Competition Commission of India (CCI) and/or the Telecom Regulatory Authority of India (TRAI), which is received after the Tribunal approval. In this case, business combination accounting under Ind AS 103 should be done on the date on which all substantive approvals, i.e., Tribunal, CCI and/or TRAI, are received. This may or may not correspond to the date specified in the agreement or the appointed date in a merger scheme. This creates unique challenges for Ind AS companies. To address these challenges, and ensure compliance with Ind AS 103 companies may consider one of the following two approaches:

**The appointed date and the effective date could be set out in the court scheme to be the date when the Tribunal passes the final order approving the scheme.** The Madras High Court’s order dated 6 June 2016 in the case of Equitas recognises this practice. Through the Madras High Court’s order, such an approach was clearly allowed under the Companies Act, 1956; however, Ind AS companies may consult legal professionals and consider adopting the same approach under the 2013 Act also. By keeping the appointed date the same as the effective date, Ind AS companies can account for the merger scheme on the effective date, as required by Ind AS. This practice will ensure that Ind AS requirements are not breached.

**The appointed date for tax purposes and tax financial statements can be a retrospective date. However, the scheme should clearly provide that for accounting purposes in Ind AS financial statements, effective date determined in accordance with Ind AS 103 will be used.**

We believe that in general, the first alternative may be preferred as it ensures consistency between tax and accounting treatment. Also, there will be no need to file revised tax returns for past periods or maintain two sets of financial statements, one for tax purposes and another for Ind AS purposes. However, some companies may prefer the second alternative for specific tax or other reasons.

The Ind AS Transition Facilitation Group (ITFG), constituted by the ICAI, has issued its Clarification Bulletin 12. Among other matters, the Bulletin clarifies that if the scheme prescribes accounting treatment from the date which is different from the acquisition/amalgamation date in accordance with Ind AS, then the auditor will bring out the same in its auditor certificate required to be issued under the section 232(3) of the 2013 Act.

If the NCLT approves the scheme with different appointed date as compared to acquisition date under Ind AS 103, the date as approved by the NCLT under the scheme will be the acquisition date for accounting purposes. In such a situation, the company should provide appropriate disclosures in the financial statements and the auditor should consider reporting requirements of the relevant auditing standards.

We suggest that ICAI / MCA may provide appropriate clarification on this matter. In a meanwhile, Ind AS companies may consider the above principles whilst finalising their merger schemes. These are complex matters and can be challenged. We therefore recommend that companies consult their auditors, legal and tax professionals whilst finalising the scheme.
Beneficial interest in shares

Section 89 of the 2013 Act deals with declaration of beneficial interest in any share issued by a company. It requires every person acquiring/holding a beneficial interest in a share as well as the legal owner to make a declaration to the company in respect of such beneficial interest. Further, section 90 of the 2013 Act provides for investigation of beneficial ownership of shares in certain cases by the Central Government.

However, due to the absence of a definition of beneficial interest and other related reasons, the existing provisions were considered inadequate for mandating a register of beneficial owners of the company. To address this issue, the 2017 Amendment Act makes the following key amendments:

- It is clarified that beneficial interest in a share includes, directly or indirectly, through any contract, arrangement or otherwise, the right or entitlement of a person alone or together with any other person to:
  - Exercise or cause to be exercised any or all of the rights attached to such share
  - Receive or participate in any dividend or other distribution in respect of such share
- Every individual, who acting alone or together, or through one or more persons or trust, including a trust and persons resident outside India, holds beneficial interests, of not less than 25% or such other percentage as may be prescribed, in shares of a company or the right to exercise, or the actual exercising of significant influence or control, over the company, will make a declaration to the company, specifying the nature of his or her interest and other particulars, in such manner and within such period of acquisition of the beneficial interest or rights and any change thereof, as may be prescribed. However, the Central Government may prescribe a class or classes of persons who will not be required to make declaration.
- Every company will maintain a register of the interest declared by individuals as aforesaid and such register will be open for inspection by members.
- Every company will file a return of significant beneficial owners of the company and changes therein with the Registrar.
- Obligation is casted on a company that it will give notice, in the prescribed manner, to any person whom the company knows or has reasonable cause to believe to be a significant beneficial owner of the company and who is not registered as a significant beneficial owner with the company as required under this section. The information required by the notice will be given by the concerned person within a period not exceeding 30 days of the date of the notice.
- Companies not complying with the requirements will be liable to a fine.
- If any person wilfully furnishes any false or incorrect information or suppresses any material information of which he or she is aware in the declaration made under this section, that person will be liable to action under section 447 dealing with fraud.

Registered valuers

Amongst other matters, section 247 of the 2013 Act requires that a registered valuer will not undertake valuation of any assets in which he or she has a direct or indirect interest or becomes so interested at any time during or after the valuation of asset. The 2013 Act does prescribe any time period in this regard. This suggests that to undertake a valuation exercise, the registered valuer will be required to ensure independence for an indefinite period of time both before as well as after the valuation. This will be highly impractical and independence should be required only for reasonable period of time before and after the valuation.

The 2017 Amendment Act addresses this issue by providing that a registered valuer cannot be appointed for valuation of an asset in which he or she has a direct or indirect interest or becomes so interested during a period of three years prior to appointment as the valuer. Further, the valuer will be prohibited from obtaining any interest direct or indirect three years after valuation of assets by him or her. Hence, the valuer is required to ensure independence for three years before and three years after the valuation of assets.
Other matters

Foreign companies

Section 379 of the 2013 Act provides that where not less than 50% of the paid-up share capital of a foreign company is held by one or more citizens of India, or companies/body corporates incorporated in India, such company will comply with the provisions of Chapter 22 Companies Incorporated Outside India, and other provisions of the 2013 Act, as may be prescribed, with regard to the business carried on by it in India, as if it was a company incorporated in India.

Section 379 does not clarify its applicability for other companies (i.e., foreign companies where 50% of the paid-up share capital is not held by one or more citizens of India, or companies/body corporates incorporated in India) having a place of business in India whether itself or through an agent, physically or through electronic mode, and conducting any business activity in India directly or in any other manner. The 2017 Amendment Act addresses this issue by requiring the applicability of section 379 and other specified provisions of the 2013 Act to all foreign companies. For example, a foreign company needs to comply with the following requirements:

a) Deliver certified copy of documents such as the charter, statutes or memorandum and articles of the company or other instruments constituting or defining the constitution of the company, to the Registrar. If the instrument is not in the English language, a certified translation thereof in the English language should be submitted.

b) Prepare balance sheet and P&L account in the prescribed form and deliver a copy to the Registrar.

c) Audit of accounts: Get accounts pertaining to Indian business operations audited by a practicing Chartered Accountant in India or a firm or limited liability partnership of practicing Chartered Accountants. The provisions of Chapter X Audit and Auditors, and rules made thereunder, will apply, mutatis mutandis, to a foreign company.

d) Section 128 related to ‘Book of account, etc., to be kept by company,’: Maintain the books of account at the principal place of business in India, with respect to monies received and spent, sales and purchases made, and assets and liabilities, in the course of or in relation to its business in India.

e) Section 92 Annual Return: Prepare annual return, subject to such exceptions, modifications and adaptations as may be made therein by rules made under this Act.

f) Section 71 of the 2013 Act pertaining to issue of debentures

g) Provision related to registration of charges as specified under Chapter VI Registration of Charges of the 2013 Act

h) Requirements of Chapter XIV pertaining to inspection, inquiry and investigation

The 2017 Amendment Act also empowers the Central Government to exempt any class of foreign companies from complying with one or more provisions of the 2013 Act.

Punishment for fraud

Section 143(12) of the 2013 Act deals with auditors’ reporting responsibilities in case of fraud in an auditee company. It requires the following:

a) If an auditor of a company in the course of the performance of his or her duties as auditor has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed is being or has been committed in the company by its officers or employees, the auditor will report the matter to the Central Government within such time and in such manner as may be prescribed.

b) In case of a fraud involving lesser than the specified amount, the auditor will report the matter to the Audit Committee constituted under section 177 or to the board in other cases within such time and in such manner as may be prescribed.

c) The companies whose auditors have reported frauds to the Audit Committee or the board but not reported to the Central Government, will disclose the details about such frauds in the board’s report in such manner as may be prescribed.
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Class action suits

The 2013 Act has introduced the concept of class action suits. Section 245 of the 2013 Act empowers a specified number of members (minimum 100 or such percentage of total members as may be prescribed) or specified number of depositors (minimum 100 or such percentage of total depositors as may be prescribed) to file an application to the Tribunal if the members/depositors are of the opinion that the management or affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors. Amongst other matters, the members/depositors can seek from the Tribunal that the company, its directors or management should be restrained from taking specified actions. They may also seek damages or compensation from the company, its directors, auditors, any other expert, advisor, consultant or any other person for fraudulent, unlawful or wrongful act/conduct. The shareholders/members may also seek other suitable action against various parties involved in the fraudulent, unlawful or wrongful act/conduct.

The 2017 Amendment Act addresses the materiality issue by stating that instead of any fraud, only frauds involving an amount of at least INR10 lakh or 1% of the turnover of the company, whichever is lower, should be punishable with imprisonment for a term which shall not be less than six months but which may extend to 10 years and will also be liable to a fine, which will not be less than the amount involved in the fraud but which may extend to three times the amount involved in the fraud. Where the fraud involves an amount less than INR10 lakh or 1% of the turnover of the company, whichever is lower, and does not involve public interest, any person guilty of such fraud will be punishable with imprisonment for a term that may extend to five years or with a fine, which may extend to INR20 lakh or with both.

Frauds involving an amount of at least INR10 lakh or 1% of the turnover of the company, whichever is lower, will carry higher punishment.

Separately from the above requirement, section 447 of the 2013 Act deals with punishment for fraud. Section 447 states that if a person is found to be guilty of fraud, the person will be punishable with a specified term of imprisonment, which can extend up to 10 years, as well as a fine. Also, where the fraud in question involves public interest, the term of imprisonment will not be less than three years.

Section 447 or the 2013 Act do not define the term ‘person.’ Section 3(42) of the General Clauses Act, 1897 defines the term ‘person’ to include any company or association or body of individuals, whether incorporated or not. An explanation to section 447 of the 2013 clarifies the meaning of the term ‘fraud’ for the purposes of this section. It states that fraud in relation to the affairs of a company or any body corporate includes any act, omission or concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with the intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss. Wrongful gain/loss means the gain/loss by unlawful means of property to which the person gaining/losing is not legally entitled.

Section 447 of the Act is a sweeping legislation, with a very wide coverage. It applies to all people, includes omission of duties that are not typically in the nature of fraud, and contains no materiality/threshold. This implies that even frauds involving small amounts or dereliction of duties can attract the same punishment as frauds involving material amounts. Therefore, these provisions are abusive, discretionary and can be misused.

The Companies (Audit and Auditors) Rules, 2014 (as amended) prescribe a materiality limit with regard to the above reporting. Those rules also prescribe a timeframe and procedures for the auditor’s reporting. Practical issues related to auditor’s reporting on fraud were addressed through the Companies (Amendment) Act, 2015 and subsequent changes to the related rules. The 2017 Amendment Act does not contain any further changes in this regard.
The Government is applying the 2013 Act in a phased manner. Originally, 98 sections were notified for applicability from 12 September 2013. Since then, most sections of the 2013 Act have been notified and are applicable. However, the following key sections of the 2013 Act are yet to be made applicable:

At the time of finalising this publication, those provisions were not notified.

The MCA, vide notification no S.O. 3453(E) dated 15 November 2016, has notified the Insolvency and Bankruptcy Code, 2016. Pursuant to the said notification, sections 253 to 269 of the 2013 Act pertaining to ‘Revival and rehabilitation of sick companies’ and sections 304 to 323 and 325 of the 2013 Act pertaining to ‘Winding up of the companies’ stand omitted.

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### The 2013 Act - Latest status

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