

## **Highlights of the Report of the Standing Committee on Finance of the Parliament on the Companies Bill, 2009**

Companies Bill, 2009 (the Bill) was introduced on 3rd August, 2009 in the Lok Sabha and was referred to the Standing Committee on Finance of the Parliament (the SCF) for examination and report. The Bill seeks to codify a new law to regulate companies and other corporate entities and at the same time repeal the Companies Act, 1956. The SCF has recommended material changes in the provisions of the Bill. The SCF's extensive deliberations and interventions on the Bill would lead to amendments / modifications and fresh inclusions requiring recasting of several clauses and matters covered in the Bill.

### **Highlights**

#### **Some of the major changes / recommendations are highlighted below:**

1. The Supremacy of the provisions of the Company Law over Memorandum and Articles of Association or any shareholder agreement, etc. to be reinstated in the Bill.
2. The blanket ban in the Bill on ability to raise funds through public deposit relaxed. The relaxation is available to only large public companies, subject to conditions.
3. The restriction placed in the Bill on issue of shares with differential rights likely to go.
4. Premium on redemption of preference shares to be provided out of profits and not out of securities premium.
5. Public company permitted to issue secured debentures.
6. Source of promoters' contribution to be disclosed in prospectus.
7. Ability of a company to vary terms of contracts or objects mentioned in the prospectus made conditional.

8.Role and responsibilities of CFO defined – maintenance of books of accounts, preparation & filing of annual accounts, disclosure of financial information in offer document, risk management, internal control etc.

9. ID not to have any kind of pecuniary relationship at all with the Company.

10. Ceiling on managerial remuneration proposed. In case of inadequacy of profits, the payment of remuneration shall be subject to conditions prescribed.

11. MD or WTD in a listed company may not be appointed as a NED in more than 10 companies including more than 2 listed companies.

12. Directors may participate in a board meeting through video conferencing and not through other electronic means.

13. Postal ballot for adoption of compromise / arrangement with creditors to be allowed.

14. Reduction of share capital and compromise or arrangement shall be sanctioned only if the accounting treatment, if any, proposed is in accordance with the accounting standards.

15. Subsidiary companies not to have further subsidiaries.

16. Every company to have only one investment company.

17. Restriction to be placed on inter-corporate loans and investments by private companies.

18. The provisions relating to the exit mechanism for investors of a listed company, in case of merger of a listed company with an unlisted company, shall be modified to bring reference to regulations made by SEBI for giving a better opt-out or exit mechanism.

19. Merger and amalgamation of an Indian company with a foreign company or *vice versa* will require prior approval of RBI.

20. Mandatory secretarial audit for unlisted companies having paid up capital of ` 50 million or more and also for listed companies.

21. To prevent possible misuse, Class action applications can be made by prescribed number of members / creditors. Banking companies to be out of the purview of Class action.

22. Firms or bodies corporate having professionals such as chartered accountants, company secretaries etc. may also be registered as a valuer for carrying out valuation.
23. Provisions relating to striking off the name of dormant company would apply if no business is transacted in the preceding 2 financial years (1 year as per the Bill).
24. Scheme for revival and rehabilitation of sick companies to have binding effect on employees.
25. The definition of the term financial institution to be amended to make it inclusive and comprising of all financial institutions including schedule banks & NBFCs.

### **Summary of deliberations**

In addition to above, summary of certain broader issues deliberated by SCF and MCA which provides insight into the process for revising the Bill is as under:

1. **Corporate governance** – the SCF has stressed on the Corporate Governance norms and its statutory recognition.

#### SCF Recommendations:

The significant and substantive matters included in the Corporate Governance Guidelines issued by MCA which are voluntary at present be made part of the Bill itself and made mandatory for listed companies. In case of unlisted companies, these guidelines may remain voluntary. MCA suggestions / proposals / views:

Certain provisions will be included in the Bill itself which, *inter alia*, includes the following:

- a. Separation of offices of Chairman and CEO
- b. Number of companies in which an individual can become a director
- c. Appointment of ID, ED and NED
- d. Role of audit committee
- e. Risk management
- f. Institution of systems by board to ensure compliance with Laws
- g. Appointment of auditors

- h. Appointment of internal auditors
- i. Rotation of audit partners and firms

**2. Reduction in delegated legislation** - the SCF observed that the words “as may be prescribed” have been used in the Bill for around 235 times, thereby suggesting excessive role and scope of delegated legislation. MCA was advised to reconsider the provisions where substantive provisions of the Bill were left to rule making.

SCF Recommendations:

Simple procedural aspects which may require flexibility and periodic revision should continue to remain in domain of delegated legislation. The intention is not to make frequent amendment in the governing statute.

The Bill needs to have futuristic vision and all contemporary and emerging issues and anticipated problems considering corporate sector etc. would have to be appropriately addressed in the Bill. MCA suggestions / proposals / views:

Some of the matters that were proposed to be delegated will now find place in the Bill. This, *inter alia*, includes:

- a. Definition of small companies
- b. Model Articles to be prescribed in Schedule
- c. Prescription of time to refund share application money
- d. Provisions and time limit for further offer of shares, their acceptance and renunciation etc.
- e. Resolutions, contracts, agreements to be filed with ROC
- f. Rates of depreciation
- g. Format of financial statements
- h. Matters into which the auditors shall inquire while conducting audit
- i. Computation of net profit
- j. Maximum number of persons for formation of association or partnership

**3. Independent Directors** – the role and responsibility of ID which has been under debate has come into sharp focus after failure of several high

profile corporations around the world involving fraud and financial irregularities. The recent experience in India has raised questions that even highly qualified persons may not provide any insurance for corporate governance, as they are likely to trust and provide unquestioned support to the promoters.

**SCF Recommendations:**

- a. Provisions relating to ID should be distinguished from other directors in the Bill.
- b. Appointment process of ID to be made independent of the Company management – a panel / data bank under MCA to be setup. The Company is required to make a choice out of such panel.
- c. MCA to prescribe, *inter alia*, precise mode of appointment, qualifications, extent of independence from promoters or management, role and responsibilities and liabilities.
- d. Tenure of ID – 5 years.
- e. Limited liability for ID recommended.
- f. Explore the feasibility of Advisory Board for bigger companies comprising of qualified persons / professional expert.

**MCA suggestions / proposals / views:**

- a. MCA has suggested inclusion of definition of the term “non-executive director” to mean a director, who is not entrusted with responsibilities relating to day-to-day management or discharge of any executive function.
- b. Since the Bill will be a general legislation for corporate and concept of ID is new in the regulatory domain, it may not be appropriate to consider provisions in the Bill for an overriding clause for grant of immunity to IDs under other laws as well.
- c. The Bill will provide that an ID shall be held liable, only in respect of such acts of omission or commission by the company or any officer of the company which constitutes a breach or violation of any provisions of

Act, which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance and where he had not acted diligently.

- d. The Bill will provide that the role, duties and functions of ID shall be such as may be prescribed by Central Government by way of rules.

**4. Regulatory Overlap** – the SCF received suggestions from regulators i.e. RBI and SEBI regarding jurisdictional overlap in the Bill.

SCF Recommendations:

- a. The Bill should provide that MCA while providing for minimum benchmarks in the Bill should allow sectoral regulators like SEBI to exercise their designated jurisdiction through a more detailed regulatory regime, to be decided by them according to circumstances.
- b. Similarly, the overriding effect of special statutes like Banking Regulation Act also requires to be clarified, while the mandate provided to RBI under such special statutes should remain unchanged.
- c. Taking into consideration the views expressed by RBI, it needs to be articulated appropriately in the Bill that only if the Special Act is silent on any aspect, the Companies Act will prevail. Further, if both are silent, requisite provisions can be included in the Special Act itself.
- d. The status-quo in this regard may therefore be maintained and the same be suitably clarified in the Bill. This will ensure that there is no jurisdictional overlap or conflict in the governing statute or rules framed thereunder.

**MCA suggestions / proposals / views:**

The Government would try to provide basic / broad principles in respect of corporate governance in the main Act, leaving the other regulatory aspects to the sectoral regulator for improvement and articulation.

**5. Role of Auditors** – the SCF received several suggestions with regard to the role of auditors. SCF Recommendations:

NACAAS would be given sufficient mandate not only to set and oversee auditing and accounting standards, but also to monitor the quality of audit undertaken across the corporate sector. SCF has accepted suggestions received which, *inter alia*, includes the following:

- a. Prohibit offer of non audit services both "directly as well as indirectly". The term directly as well as indirectly to be defined in the Bill.
- b. Prohibition under (a) above to extend to holding company, subsidiary company and associate company of the audit client company.
- c. Process of audit and functioning of auditors to be made more independent and effective.
- d. There is a need to promote an independent regulatory regime which may have the power to:-
  - (i) recommend the standards to the Government for:
    1. corporate financial reporting,
    2. corporate audit and
    3. quality of service of professionals associated with ensuring compliance with such standards;
  - (ii) oversee, monitor and supervise the bodies involved in setting standards mentioned in (i) above;

The responsibility for setting financial reporting standards and auditing standards and monitoring their strict compliance should rest with the Government or a statutory authority set up by the Government.

**MCA suggestions / proposals / views:**

- a. It may be useful to consider giving of regulatory powers to NACAAS at appropriate stage to enforce the compliance with standards in respect of matters, after they are notified under the Bill / Act and also for overseeing and monitoring the bodies involved in setting relevant standards, including on the quality of services of members of such bodies.

- b. The government would have the power to constitute NACAAS, provide for manner of appointment, selection and nomination etc. of members of NACAAS by way of making suitable rules.

**6. Harmonization with IFRS** – in accordance with the recommendations made by Core Group set up by MCA, the Government has prepared a Road Map for convergence of Indian Accounting Standards with IFRS in a phased manner starting April 2011.

Considering the recommendation of the core group, all matters requiring harmonization with IFRS will be considered and appropriate amendments will be made in the relevant provisions of the Bill. This, *inter alia*, includes:

- a. Utilization of securities premium account
- b. Reduction of share capital
- c. Prescription of depreciation rates
- d. Schemes of mergers and amalgamations.

**7. Investor Protection** – the SCF has emphasized measures for protection of small and minority shareholders.

SCF Recommendations:

- a. Recognized Investor Association should be empowered to file class action suits & complaints.
- b. Deterrent provisions to be made in the Bill for defaulting companies who have accepted public deposits.

MCA suggestions / proposals / views:

Additional measures proposed by MCA to be incorporated in the Bill, *inter alia*, include:

- a. In-principle approval to acceptance of deposits by companies from public. Companies must be big, solvent and comply with stricter rules.
- b. Source of promoters' contribution to be disclosed in prospectus.



- c. A return to be filed with ROC in case promoters<sup>2</sup>/ top 10 shareholders<sup>2</sup> stake changes beyond a limit (to ensure audit trail of ownership).
- d. IEPF to be utilized for re-distribution of disgorged amount to identifiable victims of corporate frauds.
- e. Company to vary terms of the contracts or objects mentioned in the prospectus subject to shareholder<sup>2</sup>'s approval, public notice and exit option to shareholders.
- f. Specific disclosures in the scheme of mergers / amalgamation regarding effect of proposal on minority shareholders to be provided.

**8. Corporate social responsibility** – the SCF expressed concerns on the extent of CSR being undertaken by corporate and the need for comprehensive CSR policy.

SCF Recommendations:

- a. Provisions relating to CSR to be included in the Bill.
- b. Disclosures relating to CSR to be made in the Annual Report by Companies.

MCA suggestions / proposals / views:

The Bill may now include provisions to mandate that every company having

- net worth of ` 5 billion or more, or turnover of ` 10 billion or more;
- or
- net profit of ` 50 million or more during a year

shall be required to formulate a CSR Policy to ensure that every year at least 2% of its average net profits during the 3 immediately preceding financial years shall be spent on CSR activities as may be approved and specified by the company.

**9. Exemption regime for Small Companies, OPC, Private Companies and LLP**

Since the exemption regime for these entities is not precise and explicit in the Bill, MCA is advised to examine if the classification of entities & exemptions

or concession regime to be made applicable for each of these entities, is clearly spelt out in the relevant provisions or clauses of the Bill.

**10. Corporate Delinquency** – the SCF expressed concerns on instances of Corporate Delinquency and adequacy of the proposals made in the Bill.

SCF Recommendations:

- a. Technical or procedural defaults of companies may be seen in a broader perspective in contrast to fraudulent practices / activities, which have to be dealt with severely and decisively.
- b. MCA to incorporate suggestions relating to restrictions on subsidiaries and investment companies and inclusion of private companies within the purview of the restrictive regime governing inter-corporate loans / investments.

MCA suggestions / proposals / views:

To prevent incidence of corporate delinquency, MCA has recommended additional measures to be included in the Bill. The significant amongst them are as under:

- a. Subsidiary companies not to have further subsidiaries. Every company to have only one Investment Company.
- b. Role of Audit Committee to include determination of remuneration and terms of engagement of auditor, evaluation of auditors' independence, functioning etc.
- c. Role and functions of Nomination and Remuneration Committee regarding nomination or selection of directors etc. to be incorporated more specifically.
- d. Separation of office of Chairman and MD / CEO (transitional period of one year to be given to companies to comply with this requirement).
- e. Promoter to be included in the list of "officer in default".
- f. Rotation of individual auditor and audit firm to be made mandatory.
- g. An individual can be appointed as a director in maximum 20 companies including private companies (presently, under the Companies Act, 1956, the directorship in private companies is not

capped). Out of the limit of 20 companies, the individual cannot be a director in

- i. more than 15 public companies;
- ii. more than 7 listed companies.

h. Statutory status for SFIO - The SFIO investigation report should be treated in a manner similar to police report by the Court. Definition of “fraud” to be included in the Bill.

- i. Exemptions available to private companies for inter corporate loans and investments removed.

#### 11. **Shareholder Democracy** – provisions to be simplified.

##### SCF recommendations:

- a. As the Bill has sought to enhance the number of matters on which approval of shareholders can be sought through postal / electronic ballot, the need for proxies may become minimal. Therefore, system of proxy at company meetings to be dispensed with.
- b. Higher quorum of company meetings recommended – to be based on a reasonable proportion to be included in the Bill.

#### 12. **Foreign Companies Incorporated Outside India** – clarificatory amendments in the Bill suggested

##### SCF recommendations:

- a. The enabling provisions proposed in respect of “foreign companies incorporated outside India” does not explain unambiguously the applicability of the provisions to foreign companies which are incorporated outside India and which have a place or places of business in India. It needs to be clarified in the enabling provision whether all the foreign companies which are incorporated outside India, with place of business in India with minority shareholding will be covered.

b. It is necessary that all such “foreign companies incorporated outside India”, which have a place of business in India with or without any shareholding in the country are brought within the ambit of the Bill.

**13. Whistle Blowing mechanism** – the SCF expressed concerns on the need for an internal watchdog mechanism in the company.

MCA suggestions / proposals / views:

New provisions relating to whistle blowing mechanism for companies to be inserted in the Bill.

It may be relevant to note that the Government has separately introduced the Public Interest Disclosure and Protection to Persons Making the Disclosures Bill, 2010 in the Parliament.

### **Way Forward**

MCA will revise the Bill based on the SCF report. The Bill will then be tabled in the Parliament, discussed, debated and considered for approval. The recommendations to amend the Bill may be subject to additional amendments, if any, as the Bill passes through the Parliament.

Source: Report of Standing Committee on Finance of Parliament on Companies Bill, 2009 on 31st August 2010.

### Glossary

CEO	- Chief Executive Officer
CFS	- Consolidated Financial Statements
CSR	- Corporate Social Responsibility
ED	- Executive Director
ICAI	- Institute of Chartered Accountants of India
ICSI	- Institute of Company Secretaries of India
ICWAI	- Institute of Cost and Works Accountants of India
ID	- Independent Director
IFRS	- International Financial Reporting Standards
LLP	- Limited Liability Partnership
MCA	- Ministry of Corporate Affairs

MD - Managing Director  
NBFC - Non-banking Financial Companies  
NCAAS - National Advisory Committee on Accounting and Auditing Standards  
NCLT - National Company Law Tribunal  
NED - Non-Executive Director  
OPC - One Person Company  
RBI - Reserve Bank of India  
ROC - Registrar of Companies  
SCF - Standing Committee of Finance  
SEBI - Securities and Exchange Board of India  
WTD - Whole-time Director