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THE INDIAN COMPANIES ACT, 2013 PROVISIONS OF CORPORATE GOVERNANCE

Dr.RONAK D. RANA

(ASSISTANT PROFESSOR, NATIONAL COLLEGE OF COMMERCE, AHMEDABAD)

ABSTRACT:

The 1956 Act has been in need of a change for quite some time now, to make it more modern and applicable to corporate, regulators and other stakeholders in India. While many unsuccessful trials have been made in the past to change the existing 1956 Act, there have been quite a few changes in the administrative portion of the 1956 Act. The latest attempt to revise the 1956 Act was the Companies Bill, 2009 which was introduced in the Lok Sabha, one of the two Houses of Parliament of India, on 3 August 2009. This Companies Bill, 2009 was mentioned to the Parliamentary Standing Committee on Finance, which submitted its report on 31 August 2010 and was taken back after the introduction of the Companies Bill, 2011. The Companies Bill, 2011 was also considered by the Parliamentary Standing Committee on Finance which presented its report on 26 June 2012. Subsequently, the Bill was observed and accepted by the Lok Sabha on 18 December 2012 as the Companies Bill, 2012 (the Bill).

The Bill was then considered and approved by the Rajya Sabha on 8 August 2013. It received the President's approval on 29 August 2013 and has now become the Companies Act, 2013. The changes in the 2013 Act have great influences that are set to majorly change the manner in which corporates operate in India.

INTRODUCTION :

To make sure that better corporate governance the Stock Exchange Listing Agreement needs the appointment of independent directors on the boards of listed companies. Going further the Companies Act, 2013 has made it compulsory for companies to appoint independent directors and has also prescribed the required qualifications. This article explains the implications of the new provisions relating to independent directors. Today the corporate sector forms the backbone of the

economy. With large public funds riding on its back and involving the interests of multiple stakeholders, directly and indirectly, the corporate sector has a big responsibility on its shoulders. Whether the corporate sector will discharge its obligations effectively is an issue that has been engaging the best of minds in India and abroad.

RESEARCH METHODOLOGY

RESEARCH DESIGN:

The present study is based on the descriptive analysis.

OBJECTIVES:

1) To examine the provisions of corporate governance.

2) To analyze changes took place in corporate governance over a period of time.

3) To suggest the applicability of recent corporate governance in compare to the past.

SAMPLE DESIGN:

The present paper includes the companies act amended from 1956 till 2013 and to analyze the changes took place in the corporate governance act. The data for the paper are collected from the website of ICAI and different published journals.

CORPORATE GOVERNANCE PROVISIONS IN THE INDIAN COMPANIES ACT, 2013

The enactment of the companies Act 2013 was important development in corporate governance in 2013. The new Act replaces the Companies Act, 1956 and aims to improve corporate governance standards simplify rules and increase the interests of minority shareholders. The new Act is a major milestone in the corporate governance sphere in India can have an important impact on the governance of companies in the country. Following are the main provisions related to corporate governance that have been incorporated in the Companies Act, 2013.

(1) TYPES OF COMPANIES :

1.1 One-person company: The 2013 Act introduces a new type of entity to the existing list i.e. apart from forming a public or private limited company, the 2013 Act forms entity a 'one-person company' (OPC). An OPC means a Company with only one person as its member [section 3(1) of 2013 Act].

1.2. Private company: The 2013 Act introduces a change in the definition for a private company, inter-alia, the new requirement increases the limit of the number of members from 50 to 200. [Section 2(68) of 2013 Act].

1.3. Small company: A small company has been defined as a company, except public company.

(i) Paid-up share capital of which is not more than 50 lakh INR or such higher amount as may be prescribed which shall not be more than five crore INR

(ii) Turnover of which as per its last profit-and-loss account is not more than two crore INR or such higher amount as may be prescribed which shall not be more than 20 crore INR:

As set out in the 2013 Act, this section will not be applicable to the following:

- A holding company or a subsidiary company
- A company registered under section 8
- A company or body corporate governed by any special Act [section 2(85) of 2013 Act]

1.4. Dormant company:

The 2013 Act states that a company can be classified as main company when it is formed and registered under this 2013 Act for a future project or to hold an asset or intellectual property and has no important accounting transaction. Such a company or an inactive one may apply to the ROC in such manner as may be required for obtaining the status of a dormant company. [Section 455 of 2013 Act]

(2) BOARD OF DIRECTORS (CLAUSE 166) :

The new Act provides that the company can have a maximum of 15 directors on the Board; appointing more than 15 directors, however, will need shareholder approval. Further, the new Act wants both academic and professional qualifications for directors. It says that the majority of members of Audit Committee including its Chairperson should be able to read and understand the financial statements. Also, for the first time, duties of directors have been defined in the Act. The Act increases the roles and responsibilities of the Board of Directors and makes them more accountable. The breaking of these rules has been made punishable with fine.

(3) INDEPENDENT DIRECTOR (CLAUSE 149) : The term' Independent Director' has now been defined in the 2013 Act, with many new requirements relating to their appointment, role and responsibilities. Also some of these requirements are not in line with the corresponding requirements under the equity listing agreement [section 2(47), 149(5) of 2013 Act]. The concept of independent directors (IDs) has been introduced for the first time in the Company Law in India. It prescribes that all listed companies must have at least one-third of the Board as IDs. IDs may be appointed for a term of up to five consecutive years.

(4) RELATED PARTY TRANSACTIONS (RPT) (CLAUSE 188) :

Almost all the provisions under Section 188 of 2013 Act are quite similar to the requirements under sections 297 and 314 of the 1956 Act. Some of key changes envisaged in the 2013 Act include the following:

Need for central government approval has been removed.

The 2013 Act has widened the score of transactions such as leasing of property of any kind, appointment of any agent for purchase and sale of goods, material, services or property.

Cash at present market price has now been changed 'arm's length transaction' which has been defined in the section.

Transactions entered into with related parties now to be included in the board's report along with justification for entering into such contracts and arrangements.

Penalty for contravention of the provisions of section 297 was covered in general provisions in the 1956 Act. However, this is now covered specifically in the section itself which now extends to imprisonment.

Central government may prescribe other conditions.

(5) AUDIT AND AUDITORS (CLAUSE 139) :

The 2013 Act wag gone through extensive changes within the area of audit and auditors with a view to enhance audit effectiveness and accountability of the auditors. These changes will have a major on the audit profession. However, it needs to be noted that these changes will also have a huge impact on the company in terms of time, efforts and expectations involved. Apart from introducing new concepts such as rotation of audit firms and class action suits, the 2013 Act also increases the auditor's liability considerably in comparison with the 1956 Act.

1. APPOINTMENT OF AUDITORS

Unlike the appointment process at each annual general meeting under the 1956 Act, the auditor will now be appointed for a period of five years, with a requirement to change such an appointment at each annual general meeting [section 139(1) of 2013 Act].

Also, the 2013 Act provides that in respect of appointment of a firm as the auditor of a company, the firm shall include a limited liability partnership incorporated under the Limited Liability Partnership Act, 2008 [Explanation to section 139(4) of 2013 Act].

Also, the 2013 Act states that where a firm, including a limited liability partnership is appointed as an auditor of a company, only those partners who are chartered accountants shall be authorized to act and sign on behalf of the firm [section 141 of 2013 Act].

Section 141 of the 2013 Act also adds a list of disqualifications, and extends the disqualification to also include relatives. The Section of the 2013 Act states that a person who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company of face value exceeding one thousand rupees or such sum as may be prescribed; is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of Rs.1,00,000* ; or has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, for Rs.1,00,000*, will not be eligible to be appointed as an auditor. Also, a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed, will be disqualified from being appointed as an auditor.

It is also important to note that the draft rules include 15 relationships in the list of relatives including step son/daughter and step brother/sister.

The ineligibility also extends to person or a partner of a firm who holds appointment as an auditor in more than twenty companies as well as a person who is in full time employment elsewhere. [section 141 (3)(g) of the 2013 Act].

The definition of a relative does not give cognizance to the Code of Ethics given by the Institute of Chartered Accountants(ICAI) and thus, there can be difficulty in understands. Also, the 2013 Act does not specify as to what would constitute as indirect interest and thus if there is no guidance it would be difficult to assess the extent of implication on the audit profession.

2. MANDATORY FIRM ROTATION

The 2013 Act has introduced the concept of rotation of auditors as well as audit firms. It states that in case of listed companies (and other class(es) of companies as may be prescribed) it would be compulsory to rotate auditors every five years in case of the appointment of an individual as an auditor and every 10 years in case of the appointment of an audit firm with a uniform cooling off period of five years in both the cases. Further, firms with common partners in the outgoing audit firm will also be unsuitable for appointment as auditor during the cooling off period. The 2013 Act has allowed a transition period of three years for complying with the requirements of the rotation of auditors [section 139(2) of the 2013 Act]. Further, the 2013 Act also

gives an option to shareholders to further require rotation of the audit partner and staff at such intervals as they may choose [section 139(3) of the 2013 Act].

Currently, while the 1956 Act does not have any requirements relating to the auditor or audit firm rotation, the Code of Ethics issued by the ICAI has a requirement to rotate audit partners, in case of listed companies, after every seven years with a cooling-off period of two years.

3. NON-AUDIT SERVICES TO AUDIT CLIENTS

The 2013 Act states that any service to be rendered by the auditor needs to be approved by the board of directors or the audit committee. Plus, the auditor is not allowed to give services, which include the following:

- Accounting and book keeping services
- Internal audit
- Design and implementation of any financial information system
- Actuarial services
- Investment advisory services
- Investment banking services
- Rendering of out sourced financial services
- Management services and any other service which may be prescribed

Further, the 2013 Act provides that such services cannot be rendered by the audit firm either directly or indirectly through itself or any of its partners, its parent or subsidiary or through any other entity whatsoever, in which the firm or any other partner from the firm has important control or whose name or trademark or brand is being used by the firm or any of its partners [section 144 of the 2013 Act]. The 1956 Act currently does not specify any requirements relating to non-audit services.

These restrictions are aimed at achieving auditor independence. Auditor independence is fundamental to public confidence on the reliability of the auditors' reports. This concept adds credibility to the published financial information and value to investors, creditors, companies, employees as well as other stakeholders. Independence is the audit profession's main means of showing to the public as well as the regulators that auditors and audit firms are performing in line with established principles of integrity and objectivity. To comply with these independent rules, the 2013 Act provides for a transitional period of one year, that is, an auditor or an audit firm who or which has been performing any non-audit services on or before the begins of the 1956 Act shall comply with these provisions before closure of the first financial year after the date of starting.

4. JOINT AUDITS

The 2013 Act provides that members of the company may require the audit process to be conducted by more than one auditor [section 139(3) of the 2013 Act].

5. AUDITORS LIABILITY

The scope and extent of the auditor's liability, has been substantially enhanced under the 2013 Act. Now, the auditor is not only exposed to various new forms of liabilities, however, these liabilities prescribed in the existing 1956 Act have been made more please. The auditor is now subject to oversight by multiple regulators apart from the ICAI such as The National Financial Reporting Authority (NFRA, and the body replacing the NACAS) is now authorised to investigate matters involving professional or other misconduct of the auditors. The penalty provisions and other consequences that an auditor may now be subject to as per the 2013 Act includes monetary penalties, imprisonment, debarring of the auditor and the firm, and in case of frauds, can even be subject to class action suits.

6. ADDITIONAL RESPONSIBILITIES OF THE AUDITOR

The 2013 Act requires certain new aspects which need to be covered in an auditors' report. These include the following:

The observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company [section 143(3)(f) of the 2013 Act]

Any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith [section 143(3)(h) of the 2013 Act]

Whether the company has enough internal financial controls system in place and the operating effectiveness of such controls [section 143(3)(i) of the 2013 Act]

There are other reporting requirements given in the draft rules which are reporting on pending litigations, etc which are already covered either by the accounting standards or guidance from the ICAI, and thus result in duplication.

The 2013 Act requires an auditor to report to the central government within 30 days in a format prescribed within the draft rules, if he or she thinks that any offence involving fraud is being committed or has been committed against the company by its officers or employees [section 143(12) of the 2013 Act]. Further, where any auditor does not comply with the above requirements, he or she shall be punishable with a fine which shall be between 1 lakh INR, and to 25 lakh INR [section 143(15) of the 2013 Act]. The above requirements are in addition to the existing requirements under the 1956 Act.

(6) CORPORATE SOCIAL RESPONSIBILITY (CSR) (CLAUSE 135) :

The Ministry of Corporate Affairs (MCA) had introduced the Corporate Social Responsibility Voluntary Guidelines in 2009. These guidelines have now been included in the 2013 Act and have got legal sanctity. Section 135 of the 2013 Act,

seeks to provide that every company having a net worth of 500 crore INR, or more or a turnover of 1000 crore INR or more, or a net profit of five crore INR or more, during any financial year has the corporate social responsibility committee of the board.

This committee needs to have three or more directors, out of which, at least one director should be an independent director. The formation of the committee shall be included in the board's report. The committee shall formulate the policy, including activities specified in Schedule VII, which are as follows:

Eradicating extreme hunger and poverty

- Promotion of education
- Promoting gender equality and empowering women
- Reducing child mortality and improving maternal health
- Combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases
- Ensuring environmental sustainability
- Employment enhancing vocational skills
- Social business projects

Contribution to the Prime Minister's National Relief Fund or any other fund set-up by the central government or the state governments for socio-economic development and relief, and funds for the welfare of the scheduled castes and Tribes, other backward classes, minorities and women

Such other matters as may be prescribed

(7) DISCLOSURE AND REPORTING (CLAUSE 92) :

In the new Act, there is an important transformation in nonfinancial annual disclosures and reporting by companies as compared to the earlier format in the Companies Act, 1956.

(8) SERIOUS FRAUD INVESTIGATION OFFICE (SFIO) (CLAUSE 211) :

The 2013 Act has given legal status to SFIO. Investigation report of SFIO filed with the Court for framing of charges shall be treated as a report filed by a Police Officer. SFIO shall have power to arrest in respect of certain offences of the Act which attract the punishment for fraud. Further, the new Act has a provision for strict penalty for fraud related offences.

(9) CLASS ACTION SUITS (CLAUSE 245) :

The 2013 Act introduces a new concept of class action suits which can be initiated by shareholders against the company and auditors.

CONCLUSION

From the present study it is clearly seems that the changes took place at the beginning are quite difficult for a particular company to accept but over and above whatever changes took place are for the betterment of the company and enhance the smooth functioning of the accounting process and create the transparency as well.

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