

# **SWOT ANALYSIS** **OF** **The Companies Act, 2013**

Presentation

By

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# The Companies Act, 2013

## Historical background

- Companies Act, 1913
- Companies Act, 1956 ( 30,000 cos.)
- 25 amendments till date ( more than 8,00,000 cos.)
- Corporate scams and build up for new Bill
  - Concept paper in 2004
  - Setting up of JJ Irani Committee
  - New Companies Bill, 2008 based on recommendations of JJ Irani Committee
  - New Companies Bill, 2009
  - Reference to Standard Committee on Finance and its report in August, 2010
  - New Companies Bill, 2011

# The Companies Act, 2013

## Time line

- 18<sup>th</sup> Dec, 2012 passed by Lok Sabha
- 8<sup>th</sup> August, 2013 passed by Rajya Sabha
- 29<sup>th</sup> August, 2013 got President's assent
- 30<sup>th</sup> August, 2013 gazetted as Act no 18 of 2013

# The Companies Act, 2013

- Substantial part of law shall be in the form of rules to be prescribed in due course.
  - 29 chapters against 13 at present
  - 470 sections against 658 sections at present
  - 7 schedules against 15 at present
  - More than 400 Rules are likely.

# SWOT ANALYSIS

S- Strengths

W- Weaknesses

O- Opportunities

T- Threats

The Companies Act, 2013 from CAs perspective

# SWOT ANALYSIS- Strengths

- CSR
- Class Action Suits
- Fraud and disgorgement of gains
- Public deposits
- Transactions with directors ,KMPs and Related Parties
- Number of directors and directorship
- Audit Committee
- Payment of dividend
- Depreciation
- Revision of accounts
- Not incorporating some provisions of CA,1956

# CSR

- Section 135 read with Schedule VII
  - applicable to a co with capital of Rs. 500 Crores or more or
  - Turnover of Rs. 1000 Crores or more or
  - Net profit of Rs. 5 Crores or more during any financial year
- To spend in every financial year at least 2% of the average net profits of the co during the three immediately preceding financial years
- Local area to be given preference, activities as mentioned in Schedule VII
- To constitute a CSR Committee to formulate policy and monitor its implementation.

# Class Action Suit

- Section 37- Suit which can be filed by any person, group of persons or any association of persons affected- against misstatement in prospectus (Section 34) and inducement to invest money (Section 36)
- Section 247- Application by prescribed number of members or depositors may file class action for seeking action against mismanagement.



# Fraud

- Explanation to Section 447 defines 'fraud'.
- Any act or omission, concealment of the fact or abuse of position committed by any person himself or by other person in connivance in any manner, with intent to deceive, to gain undue advantage from or to injure the interest of the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.
- Section 447- punishment for fraud
  - Imprisonment not less than 6 months to 10 years and
  - Fine which shall not be less than the amount of fraud or 3 times of such amount.

# Disgorgement of gains

- Section 38- provides for punishment for person for acquisition of securities in fictitious name(s), or through multiple applications in different combination of names under Section 447.
- Once convicted under that, the court may order disgorgement of gains, if any made and seizure and disposal of securities in possession.
- The amount received to be credited to Investor Education and Protection Fund under Section 124.

# Deposits

- Separate Chapter with four clauses as against one section presently.
- Section 73- deposit from its members by a company - with the approval of general meeting and according to rules to be framed
- Section 76- deposit from persons other than its members by a public company having prescribed net worth, or turnover and rating from recognised rating agency.
- In both the cases secured and unsecured deposits are covered.
- Section 74 - provision of very heavy fine and imprisonment in case of default in repayment of deposits.
- Section 75- if fraudulent intentions are established, every officer responsible to be personally responsible for deposits, losses and damages.

# Transactions with directors

- Definition of Interested director- Section 2(49).
- Section 192- Restrictions on non- cash transactions (buying and selling both) involving directors- prior approval by passing resolution in general meeting.
- Section 193- Restriction on contract by OPC with Sole member- contract to be in writing, terms defined in memorandum ,recording in minutes and intimation to Registrar.

# Loan to Directors, etc.

- Section 185- No lending / guarantee / providing security- directly or indirectly to a director or to a person in whom the director is interested except:
  - Loan to MD / WTD as per conditions of service or as approved by members in special resolution
  - If lending / guarantee / security is the ordinary course of business, then if at least bank rate is charged
- A person in whom the director is interested is defined in the clause itself.

# Prohibited transactions for directors and key managerial personnel

- Section 2(51) – definition of key managerial personnel
- Section 194 - prohibition on forward dealings in securities of a company, its holding, subsidiary or associate company.
- Section 195 – Prohibition on insider trading of securities.
- Severe penalties for contravention.

# Related party transactions

- Definition of 'related party'- Section 2(76)
- Section 188- lists Related party transactions including leasing of property of any kind.
- Consent of the Board to be given by a resolution
- In case of company with prescribed share capital, prior approval of the company in general meeting is required
- Does not apply to transactions entered into by the company in ordinary course of business other than those which are not on arm's length basis.

# Loans and investment by a company

- Section 186 (2) - Limit for investments, loans, guarantees and security aggregating to the higher of
  - 60% of its paid up share capital, free reserves and securities premium or
  - 100% of its free reserves and securities premium
- Limit shall cover bodies corporates including WOS and non-corporate
- Permission to exceed this limit requires prior special resolution at the general meeting
- FS to contain disclosure on the investments made, loans, guarantees and security provided and the purpose for which the loan, guarantee / security is to be used by the recipient.
- Rate of interest on loans cannot be lower than the prevailing yield on G-sec closer to the tenor.



# Number of Directors

- **Section 149- Maximum directors** – set at 15 (12 under present Act) for all companies (including private companies which are not covered in the present Act); any increase beyond this will require special resolution (no more CG approval)
- **Minimum number**- no change from present position
- **Resident in India** - At least one director must have stayed in India for at least 182 days in the previous calendar year.
- **Limit on directorship** - One person can be director in
  - 20 companies (presently 15 companies)
  - Of which only 10 can be public companies

# Audit Committee

- All listed and other prescribed class of companies to have an Audit Committee
  - Current Act - public companies with paid up capital not less than Rs.5 crores
- Minimum three directors of which majority to be independent
  - Listing agreement – 2/3<sup>rd</sup> to be independent
- Majority members and Chairperson to be able to read and understand financial statements
- Specifies certain identified responsibilities plus Board could prescribe further terms of reference:
  - Review and monitor auditor independence and effectiveness of audit process
  - Approval to new / modification to transactions with related parties
  - Scrutiny of inter corporate loans and investments
  - Valuation of undertakings and assets of the company, if necessary
  - Monitoring end use of funds raised through public offer
- Each listed and other class of companies to set up a whistle blower mechanism including direct access to the AC chairman

# Dividend

- Section 123 - No dividend from reserves other than the free reserves.
- Restriction on declaration of interim dividend proviso to sub-clause (3) of Section 123 in case company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend.

# Bonus Shares

- Explicit provision – Section 63
  - Under previous Act, only Table A dealt with this matter.
- Issue of bonus shares
  - can be only from free reserves, securities premium and capital redemption reserve
  - Revaluation reserve cannot be used
- Other specific conditions to be fulfilled
  - AOA to permit bonus issue
  - On Board's recommendation, general body to authorise
  - There should be no default in payment of statutory dues to employees
  - No default in payment of principal and interest on deposits and debt securities
  - Partly paid shares to be fully paid up before the bonus issue
  - Bonus shares cannot be in lieu of dividend
  - Any additional conditions as may be prescribed

# Depreciation

- Section 123- to provide depreciation as per Schedule II before declaration or payment of dividend.
- Schedule II – defines depreciation. Depreciation includes amortisation.
- Present Schedule XIV- rate of depreciation and different rates based on shifts and method of depreciation
- New Schedule II- to calculate depreciation rate based on useful lives assigned to different fixed assets and shifts.

# Revision of accounts

- Distinction between reopen and recast and revision
- Section 130- reopen and recast ( on judicial directions)-
  - can be done only with approval of Tribunal and no objections from the Central Government, Income Tax Authorities, SEBI or any other regulator/authority
  - Allowed only if it is established that earlier accounts were prepared fraudulently or the affairs were mismanaged during the period casting doubt on the reliability of financial statement.
- Section 131- revision ( voluntarily by the company)
  - For the three preceding financial years
  - With the approval of the Tribunal
  - If the Board feels that financial statements are not prepared according to Section 129 ( accounting standards, format)

# Not incorporating some provisions of the CA, 1956

- Other objects in Memorandum of Association not required to be given.
- Certificate of Commencement of Business for public companies is not required .
- Provision of Central Govt. approvals under sections 295, 297 and 314 have done away with.

# SWOT ANALYSIS- Weaknesses

- Change in the definition of private company
- Sick company
- Rehabilitation and Insolvency Fund
- Investment by Investment company
- Directors remuneration
- Financial year and financial statement
- Consolidated Financial Statement



# Changes in the definition of Pvt. Co.

- Definition in Section 2(68)
- Existing section 3 (1)(iii)(b) – limit on number of its members to 50 , now raised to 200.
- Existing section 3(1)(iii)(d)- prohibits any invitation or acceptance of deposit from persons other than its members, directors and their relatives, now removed altogether.

# Sick Company

- Section 253- Only criteria of sickness is non payment to secured creditors representing 50% or more of its outstanding debts, with in 30 days from notice to pay.
- Applicability shall not be restricted to industrial companies

# Rehabilitation and Insolvency Fund

- Section-269 fund to be established for rehabilitation, revival and liquidation of the sick companies.
- Contribution by the companies voluntarily.
- Company which contributed is entitled to withdraw funds, in the event of proceedings for winding up, for payment to workmen, protecting the assets and to meet incidental costs during proceedings.
- Withdrawal restricted up to the amount contributed.
- Fund to be managed by the Central government.

# Investment by investment companies

- Section 186 (1) - A company cannot make investment through more than two layers of investment companies except:
  - when an acquisition is made abroad and such other co. has investment subsidiaries beyond two layers as per the laws of that country or
  - When subsidiary having an investment subsidiary for the purpose of meeting the requirement of any law for the time being in force.

# Directors' Remuneration

- No change in over all limit
- In case of absence or inadequacy of profits remuneration is payable subject to the provisions of Schedule V
- In Schedule V limits revised upward from those in Schedule XIII at present.
- Section 197- remuneration payable to directors who are neither MD or WTD not to exceed
  - 1% ( if there is MD or WTD)
  - 3% (if there is no MD or WTD)
- Independent director not to entitled to stock option.

# Financial Statement

- Section 2(40) defines 'Financial statement'.
- Financial statements includes cash flow statement except by
  - OPC,
  - small company and
  - dormant company.
- AS 3 does not require SMCs to prepare cash flow statement

# Financial Year

- Section 2(41) – means the period ending on the 31<sup>st</sup> March every year
  - Exception could be made by a Tribunal if a company being holding or subsidiary of a company incorporated abroad and is required to maintain accounts for a different financial year outside India
- In the first year of incorporation:
  - If incorporated before 1<sup>st</sup> Jan, then period ending 31<sup>st</sup> March of the same financial year
  - otherwise, period ending 31<sup>st</sup> March of the next financial year.
- Existing companies to align within two years.

# CFS

- Sub-section (3) of section 129 provides for preparation of CFS by a company having one or more subsidiaries and lying the same in AGM
- Rules to be provided for consolidation.
- ‘Subsidiary’ for the purpose of this clause includes ‘associates’ and ‘joint venture’.
- CFS in addition to stand alone financial statement.



# SWOT ANALYSIS- Opportunities

- One Person company
- Small company and fast track merger
- Dormant company
- Co. with charitable objects
- Prohibition of partners exceeding certain number
- Entrenchment Provision
- Independent director and Woman director
- Use of electronics in management
- New professional opportunities
- Appointment of auditors
- Removal of audits

# One Person Company(OPC)

- Definition in - section 2(62) – a company which has only one person as a member.
- Incorporation of OPC – section 3
  - as a private company
  - MOA to indicate the name of other person who shall become member in case of death or his incapacity to contract
  - Consent of that person to be filed
  - Member can change the name of other person any time
  - Other person can withdraw his consent any time
- ‘One Person Company’ to be mentioned in bracket below the name – second proviso to section 12(3).

# Small Company

- Definition in section 2(85)
  - Other than a public company
  - Paid up capital does not exceed Rs. 50 Lakhs
  - Turnover in the last year does not exceed Rs. 2 Crores
  - It is not a holding company or a subsidiary co.
  - It is not a co. registered under section 8
  - It is not a co. governed by any special Act.
- Merger or amalgamation of two or more small companies in Fast Track Mode under section 233.

# Fast Track Mode for Merger/Amalgamation

- Section 233
  - Two or more small companies
  - Holding and its WOS companies
  - Such other class as may be prescribed
- Process
  - Proposed scheme to be issued to Registrar and OL for their objections/suggestions
  - Members of all the companies in their respective general meetings to approve with at least 90%
  - Each company to file declaration of solvency with Registrar
  - Scheme to be approved by 90% in value of the creditors
  - Approved scheme to be filed with the Central Govt., Registrar and OL
  - If Registrar and OL has no objections, the Central Govt. may confirm the merger/amalgamation
  - Transferor co(s) shall be deemed to have dissolved without process of winding up.

# Dormant Company

- No definition in Section 2.
- Section 455 defines it as:
  - A company formed and registered for a future project or to hold an asset or intellectual property
  - And has no significant accounting transaction
  - Or an **inactive company** (defined in the explanation to section 455(1))
  - Can apply to Registrar to obtain the status of a dormant company
- Such company to file such documents and pay such annual fee as may be prescribed to remain as dormant.
- Can become an active company on application and payment of fee.

# Company with charitable objects

- Section 8 – licence company- existing Section 25.
- Available to one person also as OPC.
- New areas of operation added.
- In case licence is revoked, it has to either wind up or amalgamate with other such company.
- In case of wind up, the asset may be transferred to other such co or credited to Rehabilitation and Insolvency Fund.

# Prohibition of association or partnership of persons exceeding certain number

- Present section 11
  - 10 for banking,
  - 20 for others
- Section 464 – as may be prescribed up to 100 for any business.
- Shall not apply to association or partnership formed by professionals who are governed by special Acts.

# Entrenchment Provision

- Entrenchment to the effect that specified provisions of the AOA may be altered only if conditions or procedures more restrictive than those applicable for special resolution are met or complied with.
- Section 5- the articles may contain provisions for entrenchment provided these are made:
  - either on the formation of the company or
  - subsequently with the unanimous consent of all the members in the case of private company and by special resolution in the case of public company and
  - such provisions are to be notified to the Registrar.



# Independent Directors

- Additional attributes for “independent director” compared to Section 49
  - Person of integrity and possesses relevant expertise and experience;
  - Has or 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;
  - Relatives have not had pecuniary relationship or transaction amounting to two per cent or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower
  - Relatives not being / been with audit firm, internal audit firm, consulting entity, legal firm etc.,
  - Not a Nominee director
  - Not a CEO or director, by whatever name called, of any nonprofit organisation that receives twenty-five per cent or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent or more of the total voting power of the company; or
  - Other qualifications as may be prescribed.
- Annual declaration of independence
- Data bank of independent directors to be maintained by an Institute to be notified by the CG
- Detailed code of conduct for independent directors
- Liability restricted to cases where there is knowledge, consent, connivance or lack of diligence

# Woman director

- Section 149
  - Class of classes of companies, as prescribed must have at least one woman director
  - Existing companies on the date of commencement of the Act and if so prescribed to comply with the requirement within one year.

# Use of electronics in management

- Voting through electronics means by members – Section 108
- Central Govt. to prescribe rules for the class of companies and manner to exercise such voting.
- Board meetings through video conferencing or other audio visual means ---Section 173 (2).
- Provided proceedings are capable of recording with date and timing and recognition of participants.
- Central govt. to prescribe the item which can not be dealt with in a meeting with video teleconferencing.

# Internal Audit

- Section- 138 Prescribed class of companies to appoint an internal auditor
- Qualification of internal auditor- shall be either CA, CMA or such other professional as may be decided by the board
- Internal audit of functions and activities of the company.
- Rules to be framed by Central Govt. for determining the intervals for conducting internal audit.

# Law enforcement

- NCLT- powers of High court shall now be with NCLT.
- Special Courts, Mediation & Conciliation panel for speedy trial of offences under the Act.
- Serious Fraud Investigation Office (SFIO)- a separate agency for investigation of Corporate frauds.

# NFRA ,NCLT and NCLAT

- Section 132 – members of NFRA
- Section 409- technical members of NCLT
- Appearance before NCLT
  - For approvals
  - For amalgamation

# Internal Administrator for revival

- Section -259
- To be selected from databank maintained by the Central Government

# Company Liquidator

- Section 2(23) definition of ‘Company Liquidator’
- To be appointed by Tribunal in case of winding up by Tribunal and by the company or creditors in case of voluntary winding up.
- A panel to be maintained by the Central government for the purpose.



# Registered Valuer

- Section – 247 valuation of assets, properties , stocks, goodwill or other assets to estimating net worth of the company to be done by a qualified professional named as ‘ Registered Valuer’.
- To be appointed by the Audit committee and in its absence by the BOD.
- Serious consequences for contravention including refund of remuneration and payment of damages.

# Auditors appointment

- Auditors to be appointed for 5 years at a time in the AGM
- However, such appointment to be placed to AGM and ratified each year
- Before appointing / reappointing, company to obtain
  - Written consent of the auditor and
  - Certificate that the appointment will be in accordance with the conditions to be prescribed in the rules and also that the auditor satisfies the eligibility criteria prescribed.

# Auditors appointment

- If no auditor is appointed / reappointed in an AGM, the existing auditor shall continue as the auditor
- This, being a general clause, cannot prevail over the specific clause requiring audit rotation.
- All companies which are required to have an Audit Committee
  - will need to appoint an auditor after considering the recommendations of such Audit Committee
  - Presently, only listed companies are required to do this

# Auditors qualifications

- Eligibility
  - In case of an individual – should be a Chartered Accountant
  - In case of firm / LLP – **Majority partners** practicing in India should be qualified for appointment
    - In such cases, only the CA partners are authorised to act and sign
- Disqualifications (similar to the existing Act)
  - A body corporate
  - An officer or employee of the company
  - A person who is a partner, or who is in the employment, of an officer or employee of the company
  - A person in full time employment elsewhere

# Auditors Removal / Resignation

- Removal of an existing auditor within the 5 years term shall be possible only by
  - Passing of a special resolution and
  - Also CG approval
- Also, the auditor will have to be heard before the approval is given for the change of auditor.
- In case of a resignation by the auditor, there is a need to file (with company, ROC and where applicable, CAG) within 30 days a statement giving the reasons and other facts as may be relevant in regard to the resignation.
- NCLT could order for change of auditors when it is satisfied that the auditors have directly or indirectly acted in a fraudulent manner or abetted or colluded in any fraud.

# SWOT ANALYSIS - Threats

- Auditors rotation
- Cap on number of audits
- Auditors disqualifications
- Additional reporting by auditors
- Prohibited services for auditors
- NAFRA and audit
- Penalties and prosecution

# Auditors Rotation

- Listed companies and prescribed class of companies cannot have the same auditor
  - In case of a firm, after two terms of 5 years each
  - In case of an individual, after one term of 5 years
- Such outgoing audit firm cannot become auditor for a period of 5 years
  - The prohibition covers firms which have common partners too
- Such rotation will have to be effected by companies covered by this requirement within 3 years of the date of commencement of this law.

# Cap on number of audits

- Provides a cap of twenty companies per partner
  - In case of common partners between firms, the total should not exceed 20 for the partner across the firms
- Limit is set at the proprietor level or at firm level
- Earlier Act provided for limits only covering public companies



# Auditors disqualifications

- **Enhanced disqualifications**

- If the person holds any security *or interest* in the Company, *subsidiary, holding, associate or co-subsiary*
- If a relative (*yet to be defined in rules*) *holds any security* in the Company, subsidiary, holding, associate or co-subsiary in excess of *Rs.1,000 or amount as may be prescribed*
- Indebtedness or guarantee by the person or *his relative or partner* is indebted or has guaranteed *in excess of the limits* prescribed to the Company, *subsidiary, holding, associate or co-subsiary*

- **New disqualifications**

- Having *direct or indirect business relationship (of such nature to be prescribed)* with the Company, *subsidiary, holding, associate or co-subsiary*
- Relative is a director or is employed as a director or KMP in the company
- A person convicted of fraud and 10 years not having elapsed from such conviction

# Audit Reporting

- specific additional assertions required in audit reports (irrespective of company size):
  - observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company
  - any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith
  - whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls
- Rules may provide for such other requirements as deemed fit
- Mandatory for auditor (or his qualified representative) to attend the AGM, unless specifically exempt by the Company.

# Reporting of Frauds by Auditors

- Act requires auditors to report on any fraud etc., to Central Government
- There is no notice to the directors / officers / employees when such reporting is done.

# Auditors – Prohibited services

- Auditors can provide only such services as are approved by the AC / Board, but **cannot provide** the following **either directly or indirectly** to the **company, its holding and subsidiaries**:
  - 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 outsourced financial services
  - Management services
  - Any other kind of services as may be prescribed

# Auditors – Prohibited services

- **In case of an audit firm, this prohibition extends to**
  - The audit firm
  - All its partners
  - Its parent, subsidiary and associate entity and
  - Any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners

# National Financial Reporting Authority (NFRA)

- Section 132- Body with advisory role having quasi-judicial powers for ensuring compliance
- make recommendations to the Central Government on formulation and laying down of accounting and auditing policies and standards for adoption by companies and their auditors and
- monitor and enforce the compliance with accounting standards and auditing standards by companies and their auditors.

# NFRA ,audit and auditors

- Overseeing the quality of service of auditors associated with ensuring compliance with such standards
- suggesting measures required for improvement in quality of service
- powers to undertake disciplinary action against audit partners / firms for non-compliance

# NAFRA

## NAFRA

- Formulate accounting standards
- Enforce implementation of accounting standards
- Formulate auditing standards
- Enforce and supervise auditing standards
- Inspect and investigate CA firms
- Take up disciplinary matter/ actions against CAs

## ICAI

- Organise and regulate CA education set up (BOS)
- Conduct examination
- Maintain CA database and prescribe Code of Conduct
- Not to deal with formulation of accounting standards, auditing standards, Disciplinary actions against members
- To dismantle FRRB



# Penalties and prosecutions

- Harsher penalties for defaults.
- Defaults of procedural nature to be penalised by levy of monetary penalties.
- Provision for imprisonment in 26 clauses.
- The company identified as a separate entity for imposition of monetary penalties on 'officers in default'.

# Auditors - Penalties

- **Contravention of law**
  - Relating to appointment, rotation, powers and duties, prohibited services or signing of audit report – Min Rs.25 K to Max Rs.500 K
  - If done willfully with an intention to deceive – imprisonment up to 1 year and penalty of Rs.100 K to Rs.2,500 K
    - Also to refund the audit fee to the Company
    - Pay damages to those who have lost on account of such incorrect / misleading statements or particulars in his audit report
- **Prosecution by NFRA (on suo moto or reference based investigation)**
  - Penalty
    - Min Rs.100 K to 5 times the fees received, for individuals
    - Min Rs.1,000 K to 10 times the fees received, for firms
  - Debar from practice
    - Member / firm for a min 6 months to 10 years period
- **Class action suit by members / depositors** – in case of improper or misleading statements in the audit report or fraudulent, unlawful or wrongful act
  - Liability in such cases against the firm and each partner who was involved
- In case of proof of fraud / abetting to fraud, then the liability will be joint and several for the auditor, his partners and firm

# THANK YOU

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