



# Companies Act 2013

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# 90 minutes.....

- Related Party Transactions
  - » slide ..... – 30 minutes
- Corporate Social Responsibility
  - » slide.....– 20 minutes
- Internal Financial Controls
  - » slide ..... – 20 minutes
- Others
  - Dormant companies
  - Class suit actions
    - » slide .....– 10 minutes
- My learning – 10 minutes

# **Related Party Transactions**

# The Related Party Issue

- RPT – Common globally
- Approach change – Nothing wrong with RPT
  - Quality reasons
  - Propriety technology
  - Many cases transactions **SHOULD BE at OTHER THAN FAIR VALUE**
- Share information – no issues
- Information **held back raises** discomfort

# Related Party Disclosures

## FUNDAMENTALS – Why Group Ops??

1. **Enterprises operate as Groups ; not as single entity for all business**
2. **Group includes**
  - **Subsidiary**
  - **Associates**
  - **Joint Ventures**
3. **Reasons**
  - **Fiscal incentives –Direct and Indirect**
  - **Optimal allocation of resources**
  - **Core competence - Technology**
  - **Difference in Management skills, Board personnel**
  - **Differing degree of control need and “dominance factor”**
  - **Succession planning**
  - **Regulatory framework**

# Legislation in India – Comp. Act

- 297 - Board's sanction for "contracts" in which D are interested
- 299 - Disclosure of D's Interest
- 300 - Interested D not to participate
- 301 - Register of Contracts; also companies where D interested
- 303 - Register of Directors (other companies, offices held by D)

# Legislation in India – Comp. Act

- 134 (3) (h) – Directors’ Report shall specify RPTs
- **217-2A - Employee remuneration;**  
**but sub clause (b)(i) also provides disclosure of “relationship” with D, if any**
- **Sch VI - Loans to D, Investment in companies in D interested etc. separate disclosure**
- **227 4A CARO : Also, in our general 227 report comments - Personal expenses**

# Legislation in India - I T, Competition Act, Excise

- IT 1973 : Charitable Institutions 12A(b), listing in terms of 13(1(3) Manager, Trustee etc
- IT : 40(A)(2)(b) - disallowance for “excessive” payments
- IT : 80-I, 80-IA - disallowance if, transaction is in excess of fair market price
- Competition Act - Dominant or Group Undertakings
- Excise Law -- Related party sale, drawn MRTP Act now (valuation rules)
- Likely many others exist



# Clause 49

## Role of Audit Committee

- Reviewing with Management, the Annual Financial Statements before submission to BoD w.r.t  
“Disclosure of related party transactions”
- RPT has same meaning as in AS 18

# Clause 49

## Review of Information by Audit Committee

- Mandatorily review “ Statement of significant RPT ( as defined by audit committee), submitted by management”
- Review what?
  1. Whether all transactions are reported
  2. Adequacy of disclosures
  3. Bonafides of the transaction –propriety and need

# Clause 49

## Disclosure – Basis of RPT

1. Periodically placed before A.C.
  - Statement in summary form of transactions with RP **in the ORDINARY course of business**
2. Placed before A.C.
  - Details of material transactions with RP which are **not in NORMAL course of business**
3. Placed before A.C. with Management Justification
  - Details of **MATERIAL** individual transactions with related parties or **OTHERS** which are not on arms length basis

# Companies Act, 2013

## Related Party Transactions (RPT)

- **Sec 188 of the Companies Act, 2013**
- **Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014**

# Related Party - Definition

- Director, KMP or relative of such person – of the Company and Holding Company
- Firm in which a director, manager or relative is a partner
- Private company in which a director or manager is a member or director
- A Public Co. in which a director or manager is a director & along with relatives holds more than 2% paid up
- Any body corporate whose Board, MD or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager (**except in Professional capacity**)

# Related Party - Definition

- Any person (**except in Professional capacity**) on whose advice, directions or instructions a director or manager is accustomed to act
- Any Company which is:
  - a holding, subsidiary or an associated company of such company
  - a subsidiary of a holding company to which it is also a subsidiary

(Central Govt can add.....)

# RPT: 3 Categories

Contracts / arrangements / transactions

1. **Without** Board / Members' Approval

- **Ordinary** course of business – **arms length**

2. Specified Contracts\* / arrangements / transactions with Shareholders **prior** approval – Special resolution

- **Contract or Arrangement:** If Paid up capital is ₹ 10 crore or more
- **Transactions:** Limits prescribed in Rules – Rule 15 (3) (ii) – \*next slide

3. With Board approval: if not covered in 2 above and also not fall in 1 above i.e **specified** transactions- **not** in ordinary course of business and **not** arms length

# Related Party Transactions

## Specified Transactions

- a) Sale, Purchase or supply of any goods or materials;
- b) Selling or otherwise disposing of, or buying, property of any kind;
- c) Leasing of property of any kind;
- d) Availing or rendering of any services;
- e) Appointment of any agent for purchase or sale of goods, materials, services or property;
- f) Such related party's appointment to any Office or Place of Profit in the Company, its Subsidiary Company or Associate Company and
- g) Underwriting the subscription of any securities or derivatives thereof



# Related Party Transactions

## Specified Transactions

### a. as Contracts / arrangements:

A3

- Clauses (a) and (e) : < 25% of the annual turnover
- Clauses (b) and (e) : < 10% of the Net worth
- Clause (c) : < 10% of the Net worth
- Clauses (d) and (e) : < 10% of the Net worth

### b. appointment to office or place of Profit (in the Company / subsidiary or associate company):

- remuneration exceeding ₹ 2.5 lakh per month

### c. remuneration for underwriting the subscription of any securities or derivatives : < 1% of Net worth

**Slide 17**

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**A3**

clauses: as mentioned in the previous slide

Legal@Sify, 21-07-2014

# RPT Reporting

- Cat 2 and 3 transactions – Board report, with justification
  - *Circulate all details in notice* to board meeting
  - Interested Director not to be present in meeting
- Cat 3- If prior approval missed; ratify within 3 months
  - If not ratified, Board can avoid and concerned Director/KMP has to compensate company for loss
  - Related party not to vote at GM i.e “*Rule of majority of minority*”
  - Conviction of Director- disqualified for 5 years
- Cat 1,2 & 3- Audit Committee Approval

# **Corporate Social Responsibility**

# CSR



## Applicability –

- Constitute CSR committee
  - ✓ Net worth of Rs. 500 crore or more, or
  - ✓ Turnover of Rs. 1000 crore or more, or
  - ✓ Net Profit of Rs. 5 crore or more  
(during any of the 3 Preceding financial years)\*
  
- Committee to consist of at least 3 directors out of which **at least 1** to be independent director.
  
- Board's Report to disclose composition of CSR Committee.
  
- CSR Rules shall be applicable from the financial year 2014-15.

\* General Circular dated 18.06.2014

# CSR



## Functions of CSR Committee:

- **Formulate** and recommend to the Board, a CSR **Policy** which shall indicate the activities to be undertaken by the company as specified in Schedule VII
- **Recommend** the amount of **expenditure** to be incurred on each of the activities
- **Monitor** the CSR Policy **implementation** from time to time.
- Prepare a **transparent** monitoring mechanism for ensuring implementation of CSR initiatives

# CSR

## BOARD RESPONSIBILITY



- **To approve** the CSR Policy after considering recommendations of CSR Committee.
- **To disclose** CSR policy and initiatives in Board's report and Company's website
- **To ensure** that activities reflected in CSR policy are actually undertaken by company.
- If the company does not spend 2% of net profits as required, then Board **to report** the reasons in the Board's report.

# CSR



- At least 2% of average net profit of last 3 preceding years is spent on CSR activities every year.
- 'Net Profit' shall mean, PBT excluding profits arising from branches outside India
- Average net profit as per sec. 198 - Next slide



Before TAX profits

Exclude profits outside India

For First CSR, Net profit shall mean average of the PBT of the preceding three financial years ending on or before 31 March 2014.

CSR spent cannot be claimed as expenditure –(budget 14-15)



# Computation of Profits – Section 198\*

Particulars*	Amount
<b>Profits as per Profit &amp; Loss Account</b>	XXX
<b>Credit to be provided for:</b>	
Bounties and subsidies received from Government	XXX
<b>Credit not to be provided for:</b>	
1. Premium/ Profit on sale of shares	
2. Profits of Capital Nature – including profits on sale of undertakings	
3. Profits from sale of immovable property/ fixed assets – unless undertaken	
<b>Permissible Deductions:</b>	
1. Usual Working Charges- revenue expenditures, bonus or commission	(XXX)
2. Abnormal or Special Tax	(XXX)
3. Interest on debentures, loans or advances	(XXX)
4. Compensations/ damages in virtue of legal liability, bad debts written off...	(XXX)
<b>Non- permissible deductions:</b>	
1. Income tax paid under Income Tax Act, 1961	
2. Loss of Capital Nature	
3. Compensations/ Damages paid voluntarily	
<b>Profits as per Section 198</b>	XXX

# CSR

## WHAT Constitutes CSR Activity?

1. Eradicating **hunger, poverty and malnutrition**, promoting preventive healthcare and sanitation and making available safe drinking water
2. Promotion of **education**, including special education and employment enhancing vocation skills especially among children, woman, elderly and the differently abled and livelihood enhancement projects
3. Promoting gender equality, **empowering women**, setting up homes and hostels for women and orphans, setting up old age homes, day care centers, and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups

# CSR

## WHAT Constitutes CSR Activity?

4. Ensuring **environmental** sustainability, ecological balance, protection of flora and fauna, animal welfare, agro- forestry, conservation of natural resources and maintaining of quality of soil, air and water
5. Protection of **national heritage**, art and culture including restoration of buildings and sites of historical importance and works of art; setting up of public libraries, promotion and development of traditional arts and handicrafts
6. Measures for the benefit of **armed forces** veterans, war widows and their dependents
7. Training to promote rural **sports**, nationally recognized sports, Para Olympic sports and Olympic Sports

# CSR

## WHAT Constitutes CSR Activity?

8. Contribution to the **Prime Minister's National Relief Fund** or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women
9. Contributions or funds provided to **technology incubators** located within academic institutions which are approved by the Central Government
- 10. Rural development** projects

# CSR



## CSR Activities – Clarifications!!

- CSR activities - only in India considered.
- Only activities **NOT** exclusively for the benefit of employees of the company or their family members shall be considered as CSR.
- Company shall give **preference to the local area** and areas around it where it operates
- **Format** of annual report on CSR initiatives to be included in the Board Report by qualifying companies prescribed under draft Rules.
- .....**and keep coming!!!!**

# **Internal Financial Controls**

# Internal Financial Controls (IFC)

## Background

1. Reflecting developments in the western world
2. SOX - limits the scope to internal controls over financial reporting. However, **IFC** - all internal financial controls, including those relating to operational areas
3. Sec. 134 (5) – definition: means the **policies and procedures** adopted by the company for ensuring the **orderly and efficient conduct of its business**, including **adherence** to company's policies, the **safeguarding** of its assets, the **prevention** and **detection** of frauds and errors, the **accuracy** and completeness of the accounting records, and the **timely preparation** of reliable financial information.

# Internal Financial Controls (IFC)

## Section 134(5)

- In the case of a **Listed Company**, the Directors' Responsibility states that directors, have laid down IFC to be followed by the company and that such controls are adequate and operating effectively. **Clause 49: CEO/CFO responsibility for establishing and maintaining internal controls for financial reporting. Default-** Imprisonment upto three years or fine not less than Rs. 50,000 but may be extended to Rs. 5 lakh or with both (**for every director**) – compoundable by special court

## Section 177

- ▶ Audit committee may call for comments of auditors about internal control systems before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company
- ▶ Audit committee should act in accordance with the terms of reference specified in writing by the board, which should, inter alia, include evaluation of IFC and risk management systems

## Section 143

- The Auditor's report should also state whether the company has adequate IFC system in place and the operating effectiveness of such controls. Any failure to comply with section 143: **Imprisonment upto 1 year and fine not less than Rs. 1 lakh but may be extended to Rs. 25 lakh..**non-compoundable offence.

## Schedule IV

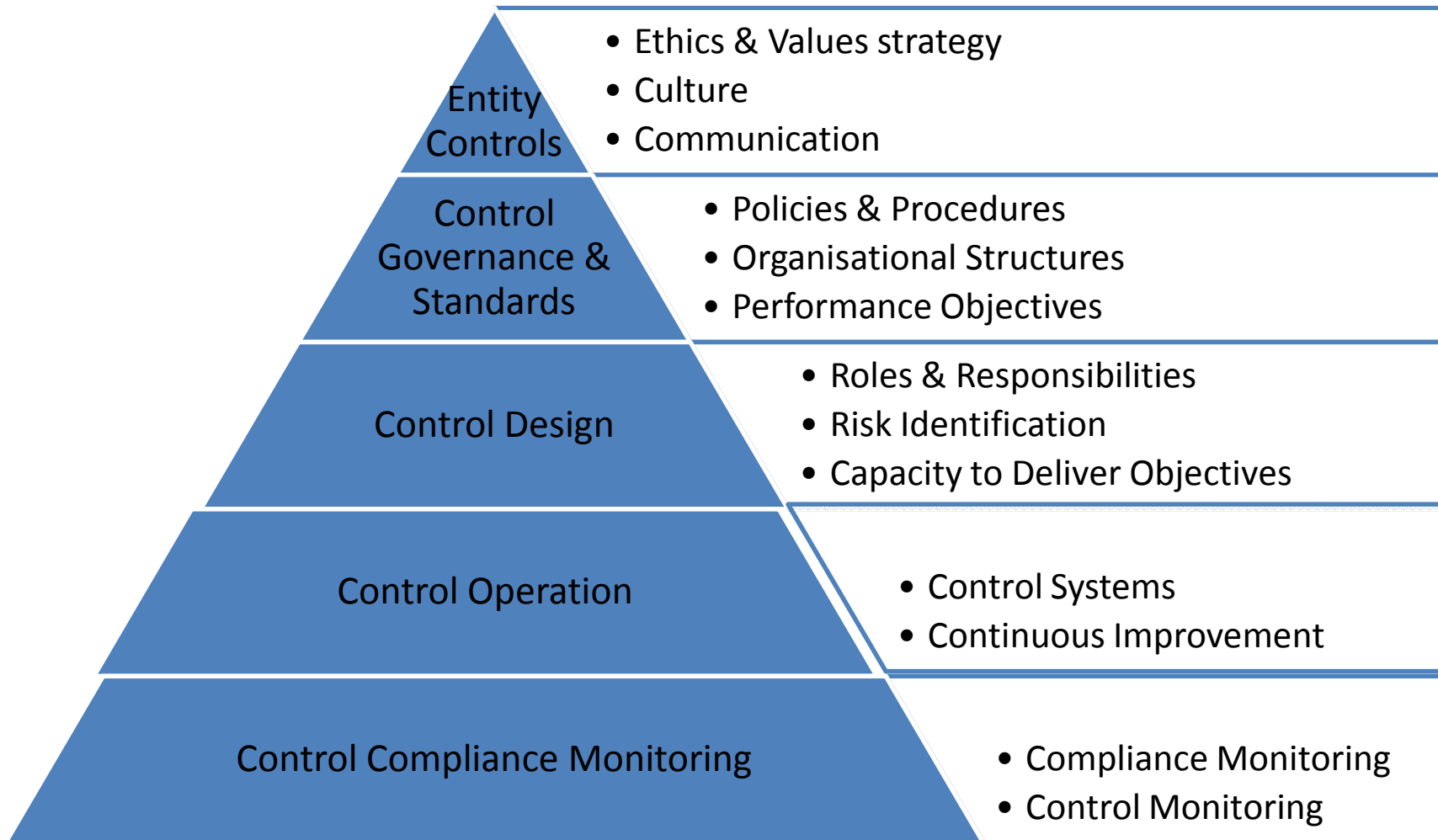
- The independent directors should satisfy themselves on the integrity of financial information and ensure that financial controls and systems of risk management are robust and defensible.



# IFC GRID

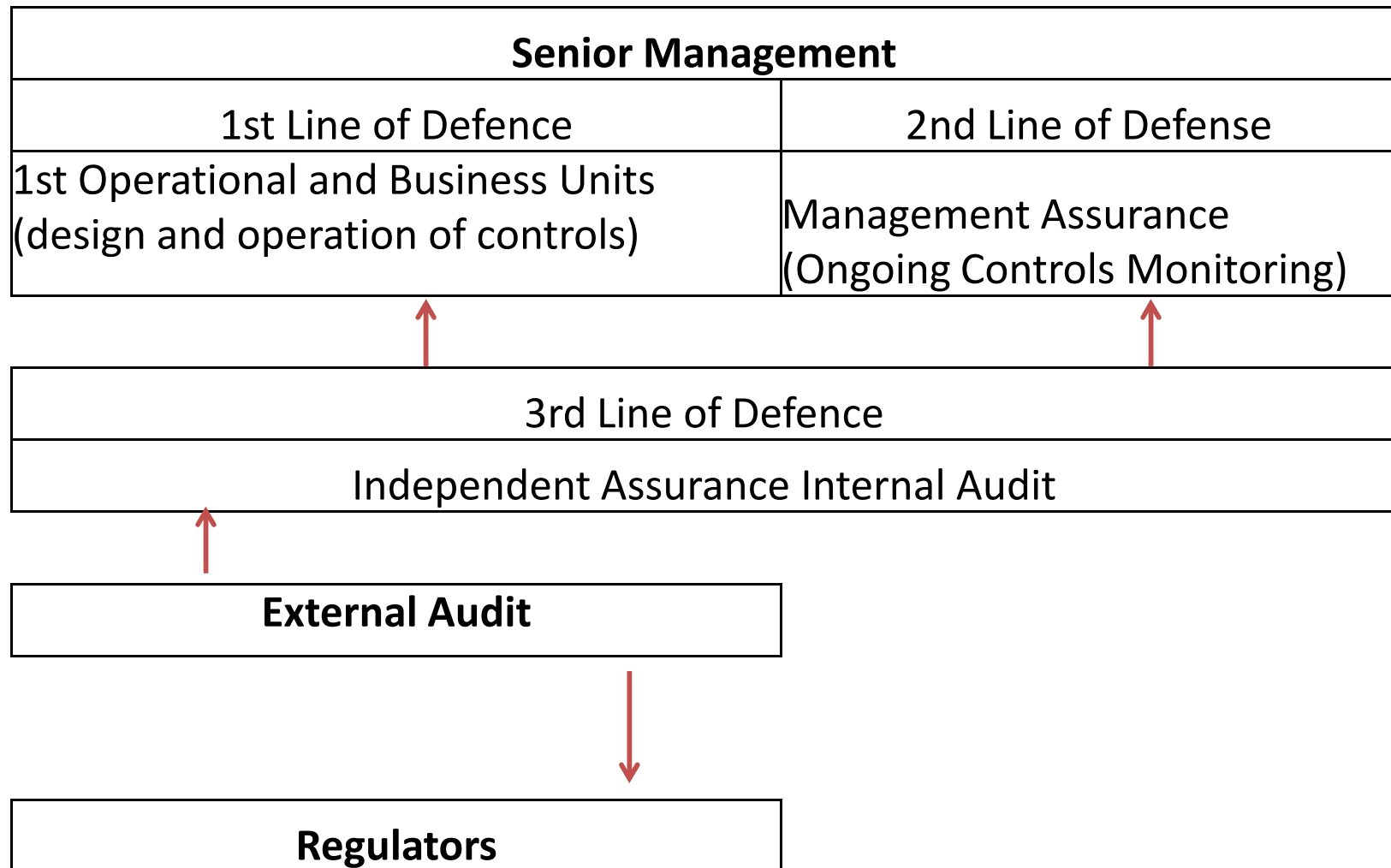
<p><b><u>Policies/Guidelines</u></b> Key policies are defined, understood and enforced</p>	<p><b><u>Operating Procedures</u></b> Clearly defined, detailed and harmonized procedures are available across the organization</p>	
<p><b><u>Technology</u></b> Several controls are preventive in nature and automated. Detective controls and monitoring processes are technology enabled with one version of truth</p>	<p><b>Assess the Current State of IFC</b></p>	<p><b><u>Roles and Responsibilities</u></b> All stakeholders are aware of their roles and responsibilities with respect to processes and controls</p>
<p><b><u>Behaviour</u></b> The culture of compliance with laid down guidelines and procedures is evident through the actions and behaviour of individuals and teams</p>	<p><b><u>Management Information System</u></b> This should ensure that adequate and accurate information is available for reporting and decision making</p>	

# IFC Elements



# IFC Implementation

## Board of Directors/Audit Committee (Overall Control)



# INTERNAL AUDIT (Sec. 138)

- Shall either be a Chartered Accountant or a Cost Accountant, or *such other professional* as may be decided by the Board
- Audit committee to formulate scope in consultation with Internal Auditor
- Transition time – 6 months
- Internal Auditor may be an employee

## Mandatory for:

- Listed Companies
- Unlisted Public company
  - Paid up capital > Rs 50cr
  - Debt > Rs.100cr or Deposits > Rs.25cr at any time during the year
  - Turnover of > Rs.200cr
- Private companies
  - Debt > Rs.100cr at any time during the year
  - Turnover . Rs.200cr

**Dormant Company**

CHAPTER XXIX	Dormant Company
<b>What is Dormant - 2 way test</b>	<ol style="list-style-type: none"> <li>1. The Company is formed and registered – unlisted <ul style="list-style-type: none"> <li>• for a future project / to hold an asset or intellectual property</li> <li>• has no significant accounting transaction</li> </ul> </li>   <li>2. The Company has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years</li> </ol>
<b>Benefits if so eligible to be dormant</b>	<ul style="list-style-type: none"> <li>➤ It can be dormant for some years and can be active later.</li> <li>➤ 2 board meetings in a year enough / rotation of auditors do not apply.</li> <li>➤ Compliances w.r.t – Balance sheet and Annual return: separate form i.e “Return of Dormant company” duly audited - in form MSC-3 to be filed within 30 days of FY closure.</li> <li>➤ Basic requirements pertaining to Min. no. of Directors / members – will continue</li> </ul>

CHAPTER XXIX

**Dormant Company**

**How to get the status**

- 1. Such Company can make an application to the Registrar in form MSC-1 + Special resolution subject to there are no pending investigation/ inquiry / prosecution / deposits / loan / disputes / pending workmen's dues
- 2. In case of a company which has not filed financial statements or annual returns for two financial years consecutively, the Registrar will issue a notice to that company and enter the name of such company in the register maintained for dormant companies.

**RoC Powers**

- 1. To issue Dormant status in form MSC-2
- 2. **To strike off** the name of the company in case the company **remains as a dormant for 5 consecutive years.**
- 3. To issue a certificate for **activating** the dormant company in form MSC-5.

**Provisions**

- 1. Sec. 455 of the Companies Act, 2013
- 2. The Companies (Miscellaneous) rules, 2014.

**PREVENTION  
OF  
OPPRESSION AND MISMANAGEMENT**

**(including Class Action Suit)**



## Chapter XVI

### O & M

- Provisions for relief in cases of oppression and for relief in cases of mismanagement are combined under one clause.
- CG may also file application to the Tribunal, if it is satisfied that the affairs of the company are being conducted in a manner prejudicial to the public interest.
- Other procedural part is now transferred to NCLT

### Class Action Suit (CAS) (Sec. 37 and 245)

Examples of CAS in US:

1. Against iGATE and its former CEO, Phaneesh Murthy
2. Against TCS by a few employees for unauthorised deductions from its employees wages
3. Against Infosys – by an employee for misusing B1 business visa

- Also known as representative action / Is a civil action A class action is brought by one or more people for themselves and other people, for the benefit, of all persons so interested
- A suit may be filed for misleading statement or inclusion or omission of any matter in the prospectus

	Chapter XVI
<b>Who can file?</b>	100 members or % prescribed (to be)  100 Depositors or % prescribed (to be)
<b>For what</b>	Management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors
<b>Against whom</b>	<ul style="list-style-type: none"><li>• the company or its directors</li><li>• the auditor or audit firm</li><li>• expert or advisor or consultant or any other person</li></ul>

## Chapter XVI

### Filing With

#### ➤ NCLT

### Comparison

#### O and M

#### CAS

Who can file

members

members and also depositors

Against whom?

the company and its statutory appointees

- the company or its directors
- the auditor or audit firm
- expert or advisor or consultant or any other person

For what

Any current or past activity or to prevent recurrence

- Any current or past or future activity including to desist from one or more particular action that have not been taken yet.



