

COMPANIES ACT, 2013 – DUTIES AND RESPONSIBILITIES OF DIRECTORS

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The Companies Act, 2013 has now been passed by the Parliament in August, 2013. It received the assent of the President on 29th August, 2013 and is notified on 30th August 2013. It will come into force from the date to be notified by the Government. The new Act will replace the existing Companies Act, 1956. 98 Sections out of 470 Sections of the Act have come into force from 12.9.2013. The provisions relating to duties and Responsibilities of Directors are contained in the following sections of the New Act.

- (i) Chapter – XI – Appointment and Qualifications of Directors (Sections 149 to 172)
- (ii) Chapter – XII – Meetings of Board and its powers (Sections 173 to 195).
- (iii) Chapter – XIII – Appointment and Remuneration of Managerial Personnel (Sections 196 to 205).

Out of the above, Sections 161 to 163, 176, 180 to 183, 185, 192, 194, 195 and 202 have come into force on 12.9.2013. Draft Rules relating to these topics are also issued for public comments.

While some of these provisions are more or less on the same lines as the provisions in the Companies Act, 1956 (existing Act) there are some new provisions which place additional duties and responsibilities on the Directors. Some of the important provisions relating to duties and responsibilities of directors under the Companies Act 2013 (New Act) are discussed in this Article.

1..Board of Directors

1.1 New Section 149 provides that the minimum number of directors in the case of a public company shall be three and in the case of a private company it shall be two. The maximum number of directors can be 15.

However, a company can provide for maximum number of directors as more than 15 by passing a Special Resolution. The Government can prescribe by Rules that in certain class of companies, there shall be at least one woman director. It is also provided that atleast one of the directors shall be a person who has stayed in India for 182 days or more in the previous calendar year. Draft Rule 11.1 states that in every listed company there should be one Woman Director who should be appointed within one year from the date of this sections coming into force. The Rule also provides that in every other public company where paid up Share Capital is Rs.100 cr. or more or turnover is Rs.300 cr. or more, a Woman Director shall be appointed within 3 years from the date on which this section comes into force.

1.2 The concept of “one person company “ (OPC) is now introduced in the new Act. This term is defined in Section 2 (62) to mean a company which has only one person as a Member. In such a company the minimum number of directors can be only one person who is a resident in India.

2. **Independent Directors**

2.1 Section 149 recognizes the concept of an “Independent Director”. This term is defined to mean a person -

- (i) Who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience.
- (ii) Who possess such other qualifications as may be prescribed.
- (iii) Who is or was not a promoter of the company, or its holding, subsidiary or associate company (hereinafter referred to as Group Companies)
- (iv) Who is not related to promoters or directors of the company or any of its group companies.
- (v) Who has or had no pecuniary relationship with any of the above persons/companies during the current or two immediately preceding financial years.

- (vi) None of his relatives has or had pecuniary relationship or transaction with the above persons amounting to 2% or more of its gross turnover or total income or Rs.50 lacs (or such higher amount which is prescribed) – which ever is lower during the current or two preceding financial years.
- (vii) Who or any of his relatives –
- (a) Holds or held the position of a key managerial personnel or as employee of the company or any of its group companies in any of the 3 financial years immediately preceding the year of his appointment.
 - (b) Is or has been an employee, proprietor or partner of the following during any of the 3 preceding financial years.
 - A firm of Auditors, Company Secretaries or Cost Auditors of the company or any of its group of companies.
 - Any legal or consulting firm which has or had transaction with the company in or any of its group companies amounting to 10% or more of the gross turnover of the firm.
 - (c) Holds, together with his relatives, 2% or more of the Voting power of the company.. or,
 - (d) is a Chief Executive or director of any non-profit organization that receives 25% or more of its receipts from the company, any of its promoters, directors or its group companies or that hold 2% or more of the total voting power of the company.
- (viii) Who is not a Managing/Whole Time/Nominee Director.

2.2 (i) Every listed Company will be required to have at least 1/3rd of the total number of directors as Independent Directors. The Government may prescribe the minimum number of independent directors in any class or classes of public Companies. Every such company will have to comply with this requirement within a period of one year from the commencement

of the new Act. It will be the duty of every independent director to give a declaration U/s.149(7) at the first Board Meeting in which he participates and thereafter at the first Board meeting of every financial year in which he participates that he meets with the above criteria of independent director. He has to intimate status of his independence from time to time. A Managing director, whole-time director or a nominee director will not be considered as an independent director.

(ii) Draft Rule 11.2 provides that a public company having paid-up capital of Rs.100 crore more, or having turnover of Rs.300 cr. or more or having aggregate outstanding Loans, Borrowings, Debentures, or Deposits exceeding Rs.200 cr. shall also have 1/3rd of the total number of directors as Independent Directors.

2.3 An Independent Director shall not be entitled to receive any remuneration other than a fee and reimbursement of expenses, for attending the meetings of the Board or any committee thereof or for any other purpose as decided by the Board. Such fees can not exceed the amount as may be prescribed U/s. 197(5). He shall also be entitled to receive profit related commission as may be approved by the members. However, he shall not be entitled to receive the benefit of stock option. It may be noted that u/s. 197(1), commission on net profits payable to all Non-executive directors (including Independent Directors) is limited to 1% of net profits of the company. If there is no managing or whole-time director, this commission can be paid upto 3% of net profit.

2.4 An Independent Director can, subject of provisions of section 152, hold office for a term of 5 consecutive years. He can be appointed as such for a further term, not exceeding 5 years, if the members pass a special resolution and disclosure of such appointment is made in the Board Report. After the expiry of 10 years period he cannot be reappointed as an Independent Director. He can, however, be appointed as such director after expiry of 3 years provided he was not directly or indirectly associated with the company in any other capacity. It may be noted that the period during which the Independent Director has held office as such director before the commencement of the new Act shall not be counted for

computing the period of 10 years stated above. Further, an Independent Director shall not be liable to retire by rotation as provided in section 152 (6) and (7). The appointment of Independent Director shall be approved by the company in General Meeting as provided in section 152(2). The explanatory statement annexed to the notice of General Meeting shall indicate the justification for choosing the Director for such appointment. This notice shall also include a statement that, in the opinion of the Board of Directors, such person fulfils the conditions in the Act for such appointment.

2.5 Draft Rule 11.3 provides for the qualifications of Independent Directors. As per this Rule, an Independent Director shall possess appropriate skills, experience and knowledge in one or more field of Finance, Law, Management, Sales, Marketing, Administration, Research, Corporate Governance, Technical Operations or Other Disciplines related to the Company's Business.

2.6 Section 149 (12) provides that (i) an Independent Director and (ii) a non executive Director (other than a promoter or key management personnel) shall be held liable only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable by the Board process. Further, he will also be liable for such acts which have occurred with his consent or connivance or where he had not acted diligently.

2.7 Section 149 (8) provides that the company and the independent directors shall Comply with the provisions specified in schedule IV. This schedule lays down a "Code of Conduct" for Independent Directors. It is stated that the adherence with this code of conduct by independent directors and fulfillment of their responsibilities in a professional and faithful manner will promote confidence of the investment community, minority shareholders, regulators and companies in the institution of Independent Directors. The schedule provides for (i) Guidelines for professional conduct (ii) Role and Functions, (iii) Duties, (iv)Manner of appointment, Reappointment, Resignation and Removal, (v) Separate Meetings of Independent Directors and (vi) Evaluation of Performance of

Independent Directors by the Board of Directors. Details about the contents of this schedule are given in Annexure I. Reading the provisions of this schedule it will be noticed that very onerous duties and responsibilities are cast on Independent Directors. It is difficult to comprehend whether the corporate sector will be able to find the required number of Independent Directors to comply with these requirements.

2.8 Any Body, Institute or Association, having expertise in creation and maintenance of Data Bank, and as may be notified by the Central Government, shall maintain a list of Independent Directors. In this list, the names, addresses and qualifications of persons eligible and willing to act as Independent Directors shall be listed. Such Data Bank shall be in accordance with the prescribed Rules. This list shall be placed on its website. Any company desiring to appoint an Independent Director will be able to select the name from such Data Bank if such person qualifies for appointment as provided in section 149 (6) as discussed in para 2.1 above. The responsibility of exercising due diligence before selecting the name shall be that of the company. The procedure for selection of the Independent Directors shall be in accordance with prescribed Rules. It may be noted that Draft Rule 11.4 provides for detailed procedure for maintenance of Data Bank.

3. Appointment of Directors.

3.1 Provisions relating to appointment of Directors are contained in Sections 151 to 172 of the new Act. These provisions are more or less on the same lines as provisions of sections 254 to 267, 274, 275, 283, 284, 303, 307 and 313 of the existing Act. It may be noted that some of the Sections out of 151 to 172 are also applicable to Private Companies. Briefly stated these provisions are as under. These provisions are applicable to private companies, unless otherwise stated.

(i) Subscribers to the Memorandum and Articles shall be the first directors, if the Articles do not make any provision.

(ii) Every director will be appointed by the company at the General Meeting.

(iii) No person shall be appointed as a director, if he is not allotted the Director Identification Number (DIN) u/s.154.

(iv) The person to be appointed as a director has to give his consent in the prescribed form which is to be filed by the company with ROC within 30 days. He has also to give his DIN particulars and a declaration that he is not disqualified under the Act.

(v) Atleast $2/3^{\text{rd}}$ of the directors on the Board of a public company shall be such that they are liable to retire by rotation. At every AGM $1/3^{\text{rd}}$ of such directors shall retire by rotation.

(vi) A person other than a retiring director shall be eligible to contest election for directorship of a public company if a shareholder proposes his name for such position and deposits Rs.1 Lac or such higher amount as may be prescribed with the company. This amount will be refunded by the company if such person is elected as director or he gets atleast 25% of votes at the AGM.

(vii) Board of Directors can appoint an additional director who shall hold office upto the next AGM. Similarly, Board can also appoint an alternate director if any director is to be out of India for more than 3 months.

(viii) A nominee of any Institution or any State/Central Government can be appointed as a director. He will be called a "Nominee Director."

(ix) The company has option by articles of association, to adopt the principle of proportional representation for appointment of Directors.

(x) Provisions in section 164 of the new Act for disqualification of a person for appointment as director are similar to provisions in section 274 of the existing Act.

(xi) Provision in section 167 of the new Act for vacation of office of a director are similar to section 283 of the existing Act.

(xii) Section 165 of the new Act provides that no person shall be a director or alternate director in more than 20 companies. It may be noted that u/s 275 of the existing Act this limit is 15 companies. Out of these, the maximum number of public companies cannot exceed 10. For computing this limit of public companies directorships in a private company which is a holding or subsidiary company of a public company shall be included. Members of a company may, by a special resolution, specify for any lesser number of companies in which its director may act as a director.

(xiii) Any person holding directorship in more than the number specified U/s. 165 has to regularize the position in one year after the commencement of the new Act.

(xiv) Section 168 of the new Act provides for resignation of a director and section 169 provides for removal by a director. Elaborate provisions in these sections are made more or less on the same lines as section 284 of the existing Act.

(xv) Every company has to maintain Register of Directors and key managerial personnel and their shareholding as provided in section 170. Members shall have right to inspect these registers u/s.171.

3.2 Section 151 provides for appointment of a director elected by small shareholders. This section is similar to section 252 (1) of the existing Act. This provision applies to listed companies. Under this section a listed company may have one director elected by such small shareholders in such manner and with such terms and conditions as may be prescribed by Rules. For this purpose, "Small Shareholder" means a person holding shares of nominal value of not more than Rs.20000/- or such other sum as may be prescribed. It may be noted that under the existing Act this provision applies to a public company having specified share capital and

specified number of small shareholders. Draft Rule 11.5 provides for detailed procedure for appointment of Small Shareholder's Director.

3.3 The above sections also provide for filing of documents with ROC and payment of additional fees for delay in filing such documents. Draft Rule 11.6 prescribes Form No. 11.2 for filing consent of Director u/s 152 (5). Draft Rules 11.7 to 11.10 provide for detailed procedure for application for DIN, allotment, cancellation etc of DIN. It may be noted that this procedure is to be complied with by directors of Private Companies also.

4. **Duties of Directors:**

4.1 Section 166 of the new Act provides that a director of a company (including a private company) shall act in accordance with the Articles of the company. His duties are listed in the section as under:

(i) He has to act in good faith in order to promote the objects of the company for the benefit of its members as a whole.

(ii) He has to act in the best interest of the company, its employees, shareholders, community and for the protection of environment.

(iii) He has to carry on his duties with due and reasonable care, skill and diligence and exercise independent judgment.

(iv) He shall not involve in a situation in which he may have a direct or indirect interest that conflicts or likely to conflict with the interest of the company.

(v) He shall not achieve or attempt to achieve any undue gain or advantage either to himself, his relatives, partners or associates.

(vi) He shall not assign his office to any other person.

4.2 If he contravenes any of the above provisions of section 166, he shall be punishable with fine which shall not be less than Rs.1 lac which

may extend to Rs.5 lacs. It is also provided that if he is found guilty of making any undue gain during the course of discharging his duties as a director, he shall be liable to refund an amount equal to such gain to the company.

4.3 Section 172 provides that if a company contravenes any of the provisions of chapter XI (sections 149 to 171), for which no specific punishment is provided, the company and every officer of the company who is in default shall be punishable with minimum fine of Rs.50000/- which may extend to Rs.five lacs.

4.4 Draft Rules 11.11 to 11.15 provide for procedure for Notice of Candidate to be appointed as Director, Notice of Resignation of Directors, Maintenance of Register of Directors, KMP etc.

5. **Meetings of Board of Directors and its powers**

5.1 Sections 173 to 195 of the new Act provide for meetings of the Board of Directors and its powers. These provisions are applicable to private companies, unless otherwise specified. Most of these procedural provisions are similar to sections 49, 285 to 302, 319, 320 and 372 A of the existing Act.

5.2 **Meetings of the Board**

Broadly stated, the provisions of sections 173 to 176 are as under.

(i) First meeting of the Board shall be held within 30 days of incorporation of the company. Thereafter minimum of 4 meetings shall be held every year. Not more than 120 days should intervene between two consecutive meetings.

(ii) Attendance by Board Members may be either in person or by video conferencing or other audio visual mode as may be prescribed.

(iii) Atleast 7 days notice in writing should be given to the directors before the date of the meeting. For any urgent business, a meeting, with shorter notice, can be held provided atleast one Independent Director is present at that meeting. If no Independent director is present at such

Board Meeting, the decisions taken at such a meeting shall be circulated to all the directors and such decisions shall be final only, if atleast one of the independent directors, ratifies the same.

(iv) Penalty of Rs.25000/- shall be levied on the officer, who is liable to give the above notice, if he fails to comply with the above procedure.

(v) One person company, small company or Dormant company can hold one Board Meeting in every six months of the calendar year. The gap between the two meetings shall not be less than 90 days. The term 'small company' is defined in section 2(85) to mean (a) a private company with paid up share capital not exceeding Rs.50 lacs or such higher amount as may be prescribed or (b) a private company whose turnover, as per last profit & loss account, does not exceed Rs. 2 crore or such higher amount as may be prescribed. This definition does not apply to a holding or subsidiary company, a company formed for charitable objects or a company governed by a special Act. A dormant company is one which is declared as such by the ROC U/s. 455 of the new Act.

(vi) If there is only one director in a "One person company", the above provisions for holding Board Meeting are not applicable.

(vii) Quorum for a Board Meeting shall be $1/3^{\text{rd}}$ of its total strength or two directors, whichever is higher. For this purpose procedure given in section 174 has to be complied with.

(viii) A resolution can be passed by circulation of papers provided it is approved by majority of directors. For this purpose procedure given in section 175 has to be complied with. However, $1/3^{\text{rd}}$ of the directors of the Company may direct that such resolution be considered at a Board Meeting.

(ix) Draft Rules 12.1 and 12.2 provide for procedure for attendance by a Director through Video Conferencing or other Audio Visual Means, Draft Rule 12.3 provides for passing resolution by circulation.

5.3 Audit Committee

The provisions relating to constitution and powers and duties of Audit Committee members are contained in section 177 of the new Act. They are on the same lines as contained in section 292A of the existing Act. Broadly stated these provisions are as under.

(i) Board of Directors of every listed company and such other class of companies as may be prescribed has to appoint an Audit Committee of the Board. (Refer Draft Rule 12.4)

(ii) There shall be minimum of 3 Directors on such Committee in which majority shall be of Independent Directors. Majority of members of the committee, including the chair person, shall be persons with ability to read and understand financial statements. The existing Audit Committee, shall be reconstituted to meet with the requirements of section 177 within one year from the commencement of the new Act.

(iii) The terms of reference for the Audit Committee should be specified by the Board. These should include items specified in section 177(4). These are on the same lines as existing section 292A. In particular, reference can be made to some significant functions of Audit Committee.

- (a) Approval of transactions with related parties.
- (b) Scrutiny of Inter-corporate Loans & Advances.
- (c) Valuation of undertakings or assets of the company wherever it is necessary.
- (d) Monitoring the end use of funds raised through public offers and related matters.
- (e) Recommend appointment of Auditors, their remuneration, terms of appointment etc. and monitoring their performance.
- (f) Examination of financial statements and auditors report thereon.
- (g) Evaluation of internal financial controls and risk management systems.

(iv) Every listed company or such class of companies as may be prescribed has to establish a vigil mechanism for directors and employees

to report concerns in such manner as may be prescribed. (Refer Draft Rule 12.5). Such vigil mechanism should provide for adequate safeguards against victimization of persons who use such mechanism. Direct access to the chairperson of the audit committee in appropriate or exceptional cases should be provided in such a mechanism. Details of such mechanism should be disclosed by the company on its website, if any, and the Board's Report.

5.4 **Nomination and Remuneration Committee**

Section 178 is a new section. It provides for appointment of Nomination and Remuneration Committee. This section provides as under.

(i) This Section provides that in the case of a listed company and such other class of companies as may be prescribed, the Board of Directors shall appoint a "Nomination and Remuneration Committee". The committee shall consist of 3 or more non-executive directors. Out of this not less than one-half shall be Independent directors. It is also provided that the chair person of the company, who is non-executive Director, may be appointed as member of the committee, but he shall not chair such committee.

(ii) The functions of this committee shall be as under –

(a) To identify persons who are qualified to become directors and recommend to the Board for such appointment.

(b) To identify persons who may be appointed in senior management in accordance with the criteria laid down for this purpose and make recommendation to the Board. The committee can also recommend removal of such person. For this purpose "Senior Management Personnel" shall mean a person who is member of Core Management Team and is placed one level below the Executive Director.

(c) To carry out evaluation of every directors' performance.

(d) To formulate the criteria for determining modifications, positive attributes and independence of a director and recommend to the Board a policy relating to remuneration for the directors, key managerial personnel and other employees. While formulating this policy the committee has to follow the guidelines given in section 178(4). The Board of Directors have to disclose the policy laid down by the Board in the Board Report.

(iii) Draft Rule 12.4 provides that besides a listed Company a public company with paid up capital of Rs.100 cr. or more or whose aggregate outstanding loans, borrowings, debentures or deposits exceed 200 cr. has to appoint an Audit Committee and a Nomination and Remuneration Committee. Similarly, listed companies and other companies which accept deposits which accept deposits from public and have borrowed money from banks and public financial institutions in excess of Rs.50 cr. shall have vigil mechanism as provided in Draft Rule 12.5.

5.5. Stakeholders Relationship Committee.

New Section 178 also provides for appointment of Stakeholders Relationship Committee. This provision is as under.

(i) In the case of a company which has more than 1000 shareholders, Debenture-holders. Deposit – holders, and any other Security – holders at any time during the financial year it is necessary for the Board of Directors to constitute a “Stake holders Relationship committee”. The committee should consist of a chair person who is a Non-executive Director and such other members as may be decided by the Board. This committee has to consider and resolve the grievances of the security holders of the company.

(ii) The chairperson of the “Nomination and Remuneration Committee” and “Stake holders Relationship committee” or any member of the committee authorised by him shall attend the General Meeting of the Company.

5.6 Penalty

In case of contravention of the provisions of section 177(Audit Committee) and section 178 (as stated in para 5.4 and 5.5 above), the company will be punished with minimum fine of Rs.1 lac which may extend upto Rs.5 lacs. Further, every officer of the company in default will be punishable with imprisonment for a term which may extend to one year or with minimum fine of Rs.25000/- which may extend upto Rs.1 Lac or both.

6. Powers of the Board of Directors

6.1 Section 179 of the new Act is similar to sections 291 – 292 of the existing Act. Under this section the Board is entitled to exercise all such powers and to do all such acts and things as the company is authorised to do under the Act, Memorandum and Articles of Association of the company. All these powers are similar to the powers granted under the existing Act. Draft Rule 12.6 give list of powers which the Board of Directors can exercise.

6.2 However, section 180 of the new Act places certain restrictions on the powers of the Board which are similar to restrictions u/s. 293 of the existing Act. These restrictions relate to borrowings, investment, disposal of company's undertakings etc. These powers can be exercised within the limitation specified in the Special Resolution of the Company. The section has come into force on 12.9.2013. It may be noted that Section 180 of the New Act applies to all Private Companies whereas the existing Section 293 does not apply to a private company unless it is a subsidiary of a public company.

6.3 New sections 181 to 183 provide for contribution which the Board of any Public or Private Company can make subject to certain restrictions, to following institutions. These sections are similar to section 293(1) (e), 293A and 293B of the existing Act. These Sections have come into force on 12.9.2013.

(i) Contributions to bona fide charitable and other funds: Prior permission of the company in General Meeting will be required if such

amount exceeds 5% of average net profits for the preceding 3 financial years.

(ii) Contributions to recognised Political Parties: Such contribution cannot be made by a Government Company or by a company which is in existence for less than 3 financial years. Such contribution cannot exceed 7.5% of the average net profits of preceding 3 financial years. It may be noted that U/s.293A of the existing Act the limit is 5% of such average net profits of 3 earlier years. The other procedural provisions explaining how to determine direct and indirect contributions, disclosure in the financial statement etc. are on the same lines as in section 293A of the existing Act. In the event of contravention of this section, the company will be punishable with a fine which may extend to 5 times the amount wrongly contributed. Further, every officer in default will be punishable with imprisonment for a term which may extend to 6 months and with a fine which may extend to 5 times the amount wrongly contributed.

(iii) Contribution to National Defense Fund or any other fund approved by the Central Government for the purpose of national defense. The company has to disclose details of such contribution in its profit & loss account.

6.4 Disclosure of Interest by Directors

Section 184 of the new Act provides for disclosure of interest by every director on the same lines as Sections 299 and 300 of the existing Act. He has to disclose his interest in any company, corporate body, Firm, LLP, or other association of Individuals and his share holding (exceeding the limit of 2% specified in section 184(2) in the prescribed manner. It is also provided that he cannot participate in the meeting where any contract or arrangement is considered. The provisions of New Section 184 apply to private Companies also. If any director contravenes this provision he will be punishable with imprisonment for a term which may extend to one year or with minimum fine of Rs.50000/- which may extend to Rs. one lac or with both. It may be noted that at present there is no provision for imprisonment in section 299 of the existing Act. Draft Rule

12.7 prescribes Form No.12.1 for disclosure of interest by a director of his interest. Procedure for this purpose is also given in this Rule.

6.5 Loans to Directors

(i) Section 185 of the new Act provides that no advance or loan can be given by a public or private company, directly or indirectly, to its director, his relative, partner or any associate concern in which he is interested. Similarly, no guarantee or any security in connection with any loan taken by him or such person shall be provided by the company. Under this section a loan will include a book debt which is in the nature of loan or advance. Similar provisions can be found in section 295 of the existing Act. This section has come into force on 12.9.2013.

(ii) However, the above provision shall not apply to.

(a) Any loan given to a managing or whole-time director if such loan is given as part of service condition as are applicable to all its employees or is pursuant to a scheme approved by members. by a special Resolution.

(b) Any loan given by the company which in the ordinary course of its business provides loans or gives guarantees or security, provided the interest charged is not a rate less than the Bank Rate declared by RBI.

(iii) It may be noted that u/s 295 of the existing Act, such loan or guarantee can be given after obtaining Central Government permission. Moreover, this restriction does not apply to private companies under the existing Act. There is no such provision in section 185. As the new Section 185 starts with the words "*save as otherwise provided in this Act*" it appears that any such Loan or Guarantee to be given to a Director or Relative etc. can be given with the prior approval of shareholders by a Special Resolution as provided in the new Section 186 discussed in Para 7 below.

(iv) It may be noted that as this section applies to private companies, loans given to Directors, their relatives and other associate concerns

outstanding on 12.9.2013 may be treated as in contravention of this section. This will create hardship to such companies. The Government should clarify that if such loans are regularized within a period of one year or so no penal action will be taken.

(iv) In the event of contravention of this section, the following penalty is provided.

(a) Company will be punishable with minimum fine of Rs.5 lac which may extend upto 25 lacs.

(b) Director or his associate who has contravened the above provisions and received the loan, guarantee etc. will be punishable with imprisonment which may extend to six months or with minimum fine of Rs.5 lacs which may extend to Rs.25 lacs or with both.

It may be noted that the above minimum fine is provided without any reference to the amount of loan or guarantee.

7. Loan or Investment by a Company

7.1 Section 186 of the new Act corresponds to section 372A of the existing Act. This section provides for limitation on loans and investments by a company, whether public or private. Briefly stated these provisions are as under.

(i) Inter-corporate investments cannot be made through more than two layers of investment companies. There are, however, two exceptions viz.

(a) acquisition of a foreign company which has investment subsidiaries beyond two layers as per law of the foreign country and (b) investment in a subsidiary which is required to have one or more investment subsidiaries in accordance with the applicable law.

(ii) A company cannot, directly or indirectly, give loan to a body corporate or any person, give guarantee or provide security for any loan to a body corporate or other person or make inter-corporate investment exceeding 60% of its paid up capital, free reserves and securities premium account

or 100% of its free reserves and securities premium account, whichever is more.

(iii) If such inter-corporate loans, guarantees, investments etc .exceed the above limits, prior approval by a Special Resolution of members at a General Meeting will be required.

(iv) Full disclosure about such inter-corporate loans, guarantees or investments will have to be made by the company in its financial statements. Further, in the case of such loans, the purpose for which the person receiving such loan proposes to utilize should also be disclosed.

(v) The inter corporate loans, guarantees, investments, etc. will require prior approval by a resolution to be approved by all the directors present at the Board Meeting. Prior approval of the Financial Institutions from which term-loans are taken and outstanding will also be required if such loans and investments exceed the limits stated in (ii) above.

(vi) No company registered under section 12 of SEBI Act, and covered under the class of companies as may be prescribed can take inter-corporate loans or deposits exceeding the prescribed limits. Details of such loans/deposits shall be disclosed in the financial Statements of such a Company.

(vii) The rate of interest for such loans shall not be less than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan.

(viii) A company which has made default in repayment of deposits or in payment of interest thereon shall not give such loans or guarantees or make such investment during the period when such default continues.

(ix) The company making such loans, investments etc. shall keep a Register in the prescribed manner which shall be open for inspection as provided in section 186(10),

(x) The Central Government shall make Rules for the purposes of this section.

(xi) This section does not apply to companies engaged in the business of banking, insurance, or housing finance if the transaction is in the ordinary course of business. The section also does not apply to a company engaged in the business of financing companies, providing infrastructure finance and to NBFC as stated in section 186 (11)

(xii) In the event of contravention of the provisions of this section, the following punishment can be awarded.

- (a) Minimum fine of Rs.25,000/- which may extend to Rs.5 lacs can be levied on the Company;
- (b) The officer in default can be imprisoned for a term upto two years with a minimum fine of Rs.25,000/- which may extend to Rs. One Lakh.

(xiii) It may be noted that section 372A of the existing Act does not apply to a private company. No such exemption is provided in section 186 of the new Act.

(xiv) Draft Rules 12.8 to 12.11 provide for procedure to be followed by companies to which section 186 is applicable and prescribes Form No.12.2 for such loans, guarantees, investments etc.

7.2 Section 187 which corresponds to Section 49 of the existing Act provides that all investments of a Company shall be held in its own name. There are certain exceptions to the above provision which are on the same lines as section 49 of the existing Act. If investments are not held in the Company's name a Register in the prescribed manner will have to be maintained. In the event of contravention of this section, penalty as stated in para 7.1 (xii) above is leviable on the Company and the officer in default. Draft Rule 12.12 prescribes Form No.12.3 for maintenance of Register for this purpose.

8. **Related Party Transactions:**

8.1 New Section 188 which also applies to a private company corresponds with Section 297 of the existing Act. It provides for certain restrictions on related party transactions. Briefly stated these provisions are as under:-

(i) The term “Related Party” is defined in Section 2(76). This Section has come into force on 12/9/2013.

(ii) Any contract or arrangement with a related party for (a) sale, Purchase or Supply of any goods, materials, services etc., (b) Sale, Purchase, leasing etc. of any property, (c) appointment of any purchase or selling agents for goods, materials, property services etc. (d) appointment to any office of profit in the Company, its subsidiary or associate company and (e) underwriting the subscription of any securities or derivatives of the company shall be entered into without the consent of the Board by a resolution passed at its meeting. This will be subject to the conditions as may be prescribed.

(iii) In the case of a Company having certain paid-up share capital or transactions exceeding certain amount as may be prescribed, it will be necessary to obtain prior approval of members by a Special Resolution. In such a case, the member, who is a related party, shall not be entitled to vote on such special resolution.

(iv) If the above transaction is entered into with a related party in the ordinary course of business of the company at Arm’s Length prices, the above provisions will not apply;

(v) The directors will have to disclose every such contract or arrangement with a related party in the Board report to the shareholders with the justification for entering into such contract or arrangement;

(vi) If any contract or arrangement is entered into by a director or employee without authority of Board, the Company can take action

against such person and recover the loss, if any, from such defaulting person. However, such contracts can be ratified by directors within 3 months from the date of contract or shall be voidable at the option of the board and the director shall indemnify the company for the loss.

8.2 It may be noted that under section 297 of the existing Act prior approval of Central Government in respect of certain transactions with related parties is required in the cases of specified companies. This requirement is not there in sections 188 of the new Act.

8.3 Draft Rule 12.14 provides that (i) a company (Public or Private) having a paid-up share capital of Rs.100 cr. or more shall not enter into a contract or arrangement with any related party (ii) a company shall not enter into a transaction or transactions, where the transactions or transactions to be entered into.

(a) Individually or taken together with previous transactions during a financial year, exceeds 5% of annual turnover or 20% of the net worth of the company, whichever is the higher, for contracts or arrangements stated above, or

(b) relates to any office or place of profit in the company, its subsidiary or associate at a monthly remuneration exceeding Rs.1 lac, or

(c) is for a remuneration exceeding Rs.10 lacs for underwriting in Securities, except with prior approval of the company by a Special Resolution.

The draft Rule provides for procedure for obtaining approval by Special Resolution.

8.4 Any Director or employee who contravenes the provisions of this section shall be punishable as under:-

(i) In the case of listed company, the defaulting person is punishable with imprisonment for a term which may extend to one year or minimum fine of Rs.25,000/- which may extend to Rs.5 lacs or with both.

(ii) In the case of any other company, with a minimum fine of Rs.25,000/- which may extend to Rs.5 lacs.

8.5 As stated above, the term “Related Party” is defined in Section 2(76). This Section has come into force on 12.9.2013. In brief, this definition covers the following parties.

- (i) A director, a Key Management Personnel or their relatives;
- (ii) A Firm or LLP in which a director or Manager or their relatives are partners;
- (iii) A private company in which a director or manager is a member or director;
- (iv) A public company in which a director or manager is director or holds together with their relatives more than 2% of the paid up share capital;
- (v) Any Body Corporate whose Board of Directors, Managing director or Manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager of the company;
- (vi) Any person on whose advice, directions or instructions a director or manager of the Company is accustomed to act;
- (vii) Any holding, subsidiary or an associate of the Company or a subsidiary of a holding Company to which it is also a subsidiary;
- (viii) Such other person as may be prescribed (Refer Draft Rule 1.3)

8.6 **Contracts by One Person Company:**

Section 193 is a new section. It provides for procedure to be followed by One Person Company when it enters into a contract with the sole member of the Company who is also a director of that company. This Section does not apply to a contract entered into in the ordinary course of its businesses. The Section provides that the company shall inform ROC within 15 days about such contract. The particulars of the contract should be recorded in the Minutes of the Board Meeting.

9. **Register of Contracts:**

9.1 Every Company (including a private company) has to keep a register of contracts or arrangements with a director or a related party to which section 184 or 188 applies. This provision in Section 189 is similar to Section 301 of the existing Act. This register should contain the prescribed particulars. It is to be placed before every Board Meeting and will be open to inspection. This Section does not apply to transactions of sale, purchase or supply of goods, materials, services etc. with a related party if the aggregate value of such goods, services etc. does not exceed Rs.5 lacs. The Section does not apply to a banking company for collection of bills in the ordinary course of its business. In the event of contravention of the provisions of this section, penalty of Rs.25,000/- can be levied on the defaulting director. Draft Rule 12.15 prescribes Form No.12.4 for register to be maintained for this purpose. It also provides a detailed procedure for this purpose.

9.2 section 190 which corresponds existing section 302 provides for keeping record of contract of service with managing or wholetime director. Copies of such contracts shall be open for inspection. This section does not apply to a private company. In the event of contravention of this section penalty of Rs.25,000/- can be levied on the company and penalty of Rs.5,000/- for each default can be levied on the officer in default.

9.3 Section 191 which corresponds to existing sections 319-320 places certain restrictions on payments being made by a company to a director for loss of office in connection with transfer of undertaking, property or shares. The section specifies the circumstances and manner in which a director may receive any payment by way of compensation for loss of office or consideration for retirement from office etc. In the event of contravention of the provisions of this section, the director in default will be punishable with minimum fine of Rs.25,000/- which may extend to Rs.1 lac. Draft Rule 12.16 provides for procedure to be followed for compliance with section 191(1).

10.. **Restriction on Non-Cash Transactions with Directors:**

Section 192 is a new section. This section has come into force on 12.9.2013 and places certain restrictions on non-cash transactions with directors. This Section applies to a private company also. These provisions are as under:-

(i) A Director of the Company or its holding, subsidiary or associate or a person connected with him shall not acquire any asset for consideration other than cash without complying with the procedure stated in the section;

(ii) Similarly, the Company cannot acquire any asset from the above persons for consideration other than cash without complying with the provisions of the Section;

(iii) For the above purpose, the following procedure should be followed.

(a) Prior approval of the members in the General Meeting of the Company is to be obtained;

(b) If the director or the connected person is a director of the holding company, prior approval of the members of the holding company in the General Meeting is to be obtained;

(c) The notice of the above General Meetings should include particulars of the arrangement and also valuation of the assets to be acquired by the Registered Valuer;

(iv) The arrangement entered into by the Company in contravention of this section shall be voidable at the instance of the company under certain circumstances specified in Section 192(3).

11. **Prohibition on forward dealings in Securities by Key-Manageial Personnel:**

11.1 Section 194, which is a new section, has come into force on 12.9.2013 and provides that a Director of a Company or any of its Key

Managerial Personnel shall not buy in the company or in its holding, subsidiary or associate Company certain kinds of future contracts, specified in Section 194 (1), in relation to securities of the company or its group companies. If any such transactions are entered into by such persons, they will have to surrender the same to the company as provided in Section 194(3).

11.2 If any of the above persons contravene these provisions, he shall be punishable with imprisonment for a term upto 2 years or minimum fine of Rs. One lac which may extend upto Rs.5 lacs or with both.

12. Prohibition on Insider Trading of Securities:

12.1 Section 195 is a new section. It has come into force on 12.9.2013. It provides that no director or key managerial personnel (KMP) of a Company shall enter into Insider Trading. This provision will not apply to any communication required in the ordinary course of business or profession or employment or under any law.

12.2 For this purpose, "Insider Trading" is defined to mean –

- (i) Any act of subscribing, selling, dealing or agreeing to subscribe, buy, sell or deal in any securities by any director or KMP or other officer of the company either as principal or agent if such director, KMP or officer is reasonably expected to have access to any "Non-Public Price Sensitive Information" in respect of securities of the company, or
- (ii) An Act of counseling about procuring or communicating, directly or indirectly any non-public sensitive information to any person.
- (iii) "Price Sensitive Information" means any information which relates, directly or indirectly, to a company and which if published is likely to materially affect the price of securities of the Company.

12.3 Any person contravening the provisions of the section shall be punishable with imprisonment for a term upto 5 years or with a minimum fine of Rs.5 lacs which may extend to Rs.25 crores or three-times the amount of profits made out of insider trading whichever is higher or with both.

13.. **Report of Board of Directors:**

13.1 New Section 134 provides that Board of directors shall approve the financial statements, including the consolidated financial statement, before submission of the same to auditors for their report. It is also provided that the Board of directors shall prepare its report and attach auditor's report and board's report to the financial statements before placing the same before the annual General Meeting. The provisions of the new section 134 are more or less similar to the provisions of existing section 217.

13.2 It may be noted that apart from the matters which are required to be stated in board's report under the existing section 217, new section 134 requires that the board report shall include the following matters.

- (i) Number of Meetings of the Board held.
- (ii) A statement of declaration given by Independent Directors u/s 149(6);
- (iii) In the case of listed companies and such other class of companies as may be prescribed under new section 178(1), (Refer Draft Rule 12.4) Company's policy on Directors' appointment and remuneration, criteria for qualifications, positive attributes, independence of directors and such other matters specified in new section 178(3);
- (iv) Particulars of loans or guarantees given or Investments made as provided in new section 186;
- (v) Particulars of contracts or arrangements with related parties as referred to in new section 188(1) in the prescribed form;
- (vi) A statement on risk management policy;
- (vii) Corporate Social Responsibility Policy and details about development and implementation of the same together with composition

of CSR Committee. Further, reasons for not spending 2% of net profit for CSR activities to be stated as provided in Section 135(5).

(viii) In the case of listed companies and other specified companies (Refer Draft Rule 9.10) a statement about formal annual evaluation made by the Board about the performance of the Board, its committees and individual directors.

(ix) Explanations or comments of the Board on every qualification reservation or adverse remark made by the auditors in their audit report and by the company secretary in practice in his secretarial audit report.

(x) A listed company has to disclose ratio of remuneration of each director to the median employee's remuneration and such other details as may be prescribed u/s 197(12). (Refer Draft Rule 13.3)

(xi) Particulars of remuneration or commission received from a holding or subsidiary company by a MD or WTD as required u/s 197 (14).

(xii) An extract of Annual Return in the prescribed form u/s 92(3).

(xiii) Secretarial Audit Report obtained by a listed company or a specified company u/s 204 to be annexed.

(xiv) The state of the company's affairs.

(xv) Material changes and commitments, if any affecting the financial position of the company which have occurred between the end of the financial year of the company and the date of the report.

(xvi) The conservation of energy, technology absorption, foreign exchange earnings and outgo in such manner as may be prescribed.(Refer Draft Rule 9.10)

(xvii) Such other matters as may be prescribed. Draft Rules 9.10 provides for disclosure of (a) the manner in which formal annual evaluation of the Board is made (b) financial summary/ highlights, (c)

change in the nature of business, (d) Details of directors or KMD appointed or resigned during the year, (e) names of companies who have become or ceased to be subsidiary, associate or Joint Venture (f) Details of Deposits (g) Details of orders passed by Regulators Tribunal Courts etc.

13.3 In the Director's Responsibility statement, besides the matters stated in section 217(2AA) of the existing Act, the directors have to state under section 134(3) of the new Act as under.

(i) In the case of listed companies the directors had laid down internal financial controls to be followed by the company and that such internal controls are adequate and were operating effectively:

(ii) That the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.

14. **Corporate Social Responsibility (CSR)**

14.1 This is a new provision made in new section 135. This section applies to every company (including a private company) having (a) Net worth of Rs.500 cr. or more, (b) turnover of Rs.1000 cr. or more or (c) Net Profit of Rs.5 cr. or more during any financial year. Such a company has to appoint a CSR Committee of the Board consisting of 3 or more directors, out of which at least one director shall be an Independent Director. The Board Report u/s 134(3) has to disclose the composition of the CSR Committee.

14.2 The functions of CSR committee will be as under:

(i) Formulate and recommend to the Board the CSR Policy indicating the activities to be undertaken by the company. These activities shall include the activities such as eradication of extreme hunger and poverty, promotion of education, medical relief, social business projects or other activities as listed in the Schedule VII.

(ii) Recommend the amount of expenditure to be incurred on the above activities.

(iii) Monitor the CSR Policy of the company from time to time.

14.3 As stated above, the activities listed in Schedule VII relate to (a) eradicating extreme hunger and poverty, (b) promotion of education, (c) promoting gender equality and empowering women, (d) reducing child mortality and improving material health, (e) combating HIV, AIDS, Malaria and other diseases, (f) ensuring environment sustainability (g) employment and enhancing vocational skills, (h) social business projects (i) contribution to Prime Minister's National Relief Fund or 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 casts, Scheduled Tribes, other backward classes, minorities and women and (j) such other matters as may be prescribed. (Refer Draft Rule 9.11).

14.4 The Board of Directors have to consider the CSR Policy recommended by the CSR Committee and approve the said Policy. The Board has to disclose the contents of the Policy in its report to members in the prescribed manner. (Refer Draft Rule 9.11). The Board has to ensure that these activities are undertaken by the Company. The Board has also to ensure that at least 2% of the average net profits of the company during the preceding 3 financial years is spent for CSR activities. For this purpose, the company has to ensure that preference is given for CSR activities to the local area around the place where it operates. If, for any reason, the company is not able to spend the above amount in any financial year, the Board will have to state the reasons for the same in its report to the members.

15. **Internal Audit:**

15.1 There is no specific provision for appointment of Internal Auditor in the existing Companies Act. However, the statutory auditors are required to report in the CARO Audit Report whether in the cases of listed companies and other companies having paid-up capital and reserves exceeding Rs.50 lacs or have average turnover exceeding Rs. 5 crores during the last 3 preceding years have Internal audit System commensurate with the size and nature of business of the Company.

15.2 The new Act now provides in Section 138 that, in such class of companies, as may be prescribed by rules, the company shall be required to appoint an Internal Auditor. The qualification of the Internal Auditor shall be that of a Chartered Accountant, Cost Accountant or such other professional as may be decided by the Board of Directors. The Internal Auditor will have to conduct internal audit of the functions and activities of the Company. The Central Government has to frame Rules specifying the manner and intervals at which the Internal Audit is to be conducted and the manner in which the Internal Auditor will report to the Board of directors. (Refer Draft Rule 9.15(2). With this statutory recognition given to Internal Audit of specified companies, the scope for professional work for chartered accountants and cost accounts will increase. Draft Rule 9.15(1) provides that every listed company and every public company having paid up share capital of Rs.10 crores or more and a public company which has outstanding loans from banks or public financial institutions exceeding Rs.25 cr. or which has accepted Deposits of Rs. 25 cr. or more shall appoint the Internal Auditors.

16. **Appointment and Remuneration of Managerial Personnel:**

New Section 196 corresponds to existing sections 197A, 267, 269, 317, 384, 385 and 388. The procedure for appointment of Managing Director, Whole-time Director or Manager is similar to the existing provisions. Briefly stated such procedure is as under:-

(i) A Company (including a private Company) cannot have a Managing Director as well as a Manager. The term "Manager" is defined in Section 2(53) and the term "Managing director" is defined in Section 2(54).

(ii) Appointment of Managing Director (MD), Whole-Time Director (WTD) or Manager shall not be for a term exceeding 5 years. His reappointment can be made, for a further similar term, only during the last year of his earlier term.

(iii) A person below the age of 21 years cannot be appointed as MD, WTD or Manager. If he has attained the age of 70 years, such appointment can only be made by the members by a Special Resolution at a General Meeting. The Explanatory statement to the Notice calling such meeting should give details and justification for such appointment.

(iv) A person who is an un discharged insolvent or has been adjudged an insolvent or convicted from an offence and sentenced for more than one month cannot be appointed in such capacity.

(v) A person who has at any time suspended payment to his creditors or made any composition with them cannot be appointed in such capacity.

(vi) The appointment of MD, WTD or Manager can be made by the Board of directors, on the basis of recommendations of the Remuneration Committee, where required, upon such terms and conditions, including remuneration, within the limits specified in Section 197 and Schedule V. This appointment shall be subject to approval by a Special Resolution of Members to be passed at the next General Meeting. This will also be subject to Central Government approval if the terms of remuneration are at variance to the conditions specified in Schedule V.

(vii) The notice for the above Board Meeting and General Meeting for consideration of such appointment should state the details about terms of appointment, remuneration and such of the matters such as interest of Directors etc.

(viii) Prescribed Return about this appointment is to be filed by the Company with the ROC within 60 days of the date of such appointment. (Refer Draft Rule 13.1 which has prescribed Form No.13.1 for this purpose).

17. **Managerial Remuneration:**

17.1 New Section 197 and Schedule V provides for overall managerial remuneration and remuneration in the event of absence of or inadequacy of profits payable by a public Company. These provisions correspond to

existing sections 198 and 309 and Schedule XIII. In brief these provisions are as under:-

(i) Total managerial remuneration payable to MD, WTD, Manager and other directors by a public company shall not exceed 11% of net profits of the Company for the financial year. Such net profits are computed as provided in new Section 198. For this purpose remuneration of the directors shall not be deducted from the gross profits.

(ii) Except with the approval of the Company in General Meeting;-

(a) Remuneration payable to MD, WTD or Manager(if there is only one such person) shall not exceed 5% of the above net profits.

(b) If there are more than one such persons, the total remuneration payable to all such persons shall not exceed 10% of such net profits.

(c) Remuneration payable to other non-executive directors shall not exceed –

- One percent of such net profits if there is a MD, WTD or Manager.
- Three percent of such net profits if there is no MD, WTD or Manager.

(iii) The percentage stated above shall not include fees payable to directors for attending meeting of the Board or its committee. Under Sec. 197(5) it is provided that a director shall be entitled to receive such fees, as may be prescribed for attending Board or a committee Meeting or for any other business purpose as the Board may decide. The Government may prescribe different fees for different classes of companies and for Independent Directors. Draft Rule 13.2 deals with the question of payment of sitting fees to Directors. It is provided that such fees, not exceeding Rs.1 lac per meeting, can be fixed by the Board of Directors. Different fees for Independent Directors and other Directors can be fixed within the above limit.

(iv) If, in any financial year, the company has no profits or its profits are inadequate, the company can pay remuneration to its directors, MD, WTD and Manager, (other than sitting fees as stated in (iii) above) within the limits specified in Schedule V. The broad contents of Schedule V are

given in Annexure II. If such remuneration is likely to exceed the limits specified in Schedule V, it will be necessary for the company to obtain previous approval of the Central Government.

(v) The above remuneration payable to directors, including the MD, WTD and Manager, shall be in accordance with the Articles of Association or resolution of General Meeting or if the Articles so require, by special resolution passed at the General Meeting. It is further provided in Section 197(4) that the above remuneration payable to a non-executive director shall not include amount payable for services in any professional or other capacity.

(vi) A director or manager may be paid remuneration either by way of monthly payment or specified percentage of net profits of the Company or partly by one and partly by the other method.

(vii) It is specifically provided in Section 197(7) that an Independent director shall not be entitled to receive any stock option. He is entitled to receive remuneration only by way of commission or fees as stated above.

(viii) If any director receives any amount by way of remuneration in excess of the limits stated above without prior sanction of the Central Government, he will have to refund such excess amount to the Company. It will not be possible for the company to waive recovery of the excess amount without the approval of the Central Government.

(ix) A listed Company has to disclose in the Board Report the Ratio of the remuneration of each director to the median employee's remuneration and such other particulars as may be prescribed. (Refer Draft Rule 13.3).

(x) Where any insurance is taken by the Company against any liability in respect of negligence, default, misfeasance, breach of duty or breach of trust for which a MD, WTD, Manager, CEO, CFO or Company Secretary in relation to the Company, the premium paid shall not be treated as part of remuneration of such personnel. However, if such person is proved to be guilty, the premium paid by the Company shall be refunded by the concerned person to the Company.

(xi) Any MD or WTD of the Company can receive any commission or remuneration from its holding or subsidiary company subject to the above provisions. It will, however, be necessary to disclose the details of such receipts in the Board Report.

17.2 Where a Company is required to restate its financial statements due to fraud or non-compliance with any requirement under the Companies Act and Rules, the Company will have to recover from past or the present MD, WTD, Manager or CEO who has received remuneration (including stock option) which is higher than what is due on the basis of restated financial statements.

17.3 In the event of contravention of the provisions of this section, the defaulting person shall be punishable with a minimum fine of Rs. 1 lac which may extend to Rs.5 lacs.

17.4 It may be noted that every listed company has to disclose in the Board Report particulars of Remuneration paid to Directors and other managerial personnel as prescribed in Draft Rule 13.3.

18. **Method of Calculating Net Profit:**

18.1 New Section 198 provides for the method for calculation of net profit for the financial year for determining the limits for payment of Managerial Remuneration as discussed in Para 17 above. This section is similar to the existing Section 349.

18.2 Section 198 makes provision for computation of the net profit in the same manner as in existing section 349. The Section is divided into four parts as under:-

- (i) Items to be included in the income;
- (ii) Items not to be included in the income;
- (iii) Items to be considered as expenditure;
- (iv) Items not to be considered as expenditure;

18.3 Comparison of new Section 198 and existing Section 349 will show that the only difference is with regard to any change in carrying amount of

an asset or a liability recognized in equity reserves, including surplus in Profit & Loss Account, on measurement of the asset or liability at fair value. New Section 198 provides that such adjustment in the Profit & Loss Account or Equity Reserve appearing on the debit side or credit side shall be added back or deducted in the computation of net profit.

19. **Some Procedural Provisions:**

19.1 New Section 199 which corresponds to section 637A gives power to the Central Government or Tribunal to accord approval, sanction, consent, confirmation, direction, exemption etc. in relation to any matter for which such approval, sanction etc. is required under the Act. The Company will be required to apply to the Central Government or the Tribunal and pay the prescribed fees.

19.2 New Section 200 corresponds to existing section 637AA. This section provides that the Central Government or the Company while according approval u/s 196 or 197 to any appointment or remuneration to managerial personnel may fix a limit in the event of the absence or inadequacy of profit. For this purpose they may consider the financial position of the Company, amount of commission or remuneration, professional qualification and experience of the individual and such other matters as may be prescribed. (Refer Draft Rule 13.4)

19.3 New Section 201 corresponds to existing section 640B. It provides for forms and procedure in relation to the application to be made to the Central Government. Draft Rule 13.5 prescribes the procedure for this purpose and also prescribes Form No.13.2 for application to Central Government.

19.4 New Section 202 corresponds to existing Section 318. It provides for payment of compensation for loss of office by MD, WTD or Manager. The Section provides for circumstances under which such compensation will not be payable. It also provides for the quantum of compensation payable by the Company. This section has come into force on 12.9.2013.

20. **Appointment of Key Managerial Personnel: (KMP)**

20.1 Section 203 is a new section. It provides that certain specified companies, as may be prescribed by rules, shall have following whole-time key managerial personnel:-

- (i) MD, CEO, Manager or WTD
- (ii) Company Secretary
- (iii) CFO

Draft Rule 13.7 provides that every listed company and every other company, whether Public or Private, having paid up share capital of Rs.5 cr. more should have whole-time Key Management Personnel. The extension of this requirement to private company with Capital of Rs.5 crore or more will create difficulties since there may not be sufficient work for 3 officers in such a company (e.g. Investment or Property Company).

20.2 It is also provided in this section that, unless the articles of the Company provide otherwise, or the company does not carry on multiple businesses an individual shall not be the Chairperson as well as MD or CEO at the same time.

20.3 Further, it is provided in the section as under:-

(i) Every whole-time KMP shall be appointed by a resolution of the Board containing terms and conditions of appointment and remuneration.

(ii) Such KMP shall not hold office in more than one Company, except in its subsidiary at the same time. However, he can be a director in any company with the permission of the Board. If any KMP is holding such position in more than one company at the time of commencement of the New Act, he will have to select one of the Companies within 6 months of such commencement.

(iii) The company may appointment a MD who is already MD or Manager of one or more companies. Such appointment will have to be approved by the Board by a resolution to be passed at its meeting and should be approved by all the Directors present at the meeting. Specific notice

giving details of such proposal should be given for such Board Meeting. Such appointment will be subject to other provisions of the Act as discussed earlier.

(iv) If office of such KMP is vacated, it should be filled up by the Board within 6 months.

20.4 In the event of contravention of this section the following penal action can be taken.

(i) The company will be punishable with minimum fine of Rs. one lac which may extend to Rs.5 lacs.

(ii) Every defaulting director or KMP will be punishable with fine upto Rs.50000/-. In the event of continuing default, further fine upto Rs.1000/- for every day during which the contravention continues can be levied.

21. **Secretarial Audit** :

Section 204 is a new section. It applies to a listed company and to other companies as may be provided by Rules. The section provides as under:

(i) All such companies will have to obtain a Secretarial Audit Report from a Company Secretary in Practice in the prescribed form. This report will have to be annexed with the Board Report U/s.134.

(ii) The Secretary appointed for this purpose will have to audit the secretarial and related records of the company and report thereon.

(iii) If there are any qualifications, observation and other remarks in the above report, the Board will have to give explanation about the same in the Board report as provided in section 134(3).

(iv) If the company, any officer or Company Secretary in practice contravenes this section the defaulting person shall be liable to punishment by way of minimum fine of Rs.1 lac which may extend to Rs.5 lacs.

(v) Draft Rule 13.7 provides that Section 204 shall apply to a listed company and every public company having paid up share capital of Rs.100 cr. or more. Further, it is also provided that Secretarial Audit Report shall be given in Form No.13.3.

22. Functions of Company Secretary

Section 205 is also a new section. It specifies the functions of a Secretary of the company as under.

(i) To report to the Board about compliance with the provisions of the Act, the Rules and other applicable Laws.

(ii) To ensure that the company complies with the applicable Secretarial standards issued by the Institute of Company Secretaries of India.

(iii) To discharge such other duties as may be prescribed. (Refer Draft Rule 13.8 for list of duties to be performed by a Company Secretary).

23. To Sum up:

23.1 Reading the above provisions relating to powers, duties and responsibilities of directors in the new Companies Act it will be evident that some of the procedural and other provisions are on the same lines as in the existing Companies Act. However, the duties and responsibilities of Directors in certain areas, such as disclosures in financial statements and Board Report of listed Companies and other specified Companies have increased. Some of the provisions have become more stringent. It will be necessary to educate all persons who join the Board of Directors of companies about these provisions relating to their duties and responsibilities. Further, some of the provisions of the Act now apply to Private Companies. No specific time is given for compliance with these provisions to such companies after these provisions are brought into force. This will create great hardship to such companies.

23.2 Particular mention can be made about Independent Directors and Non-Executive Directors of listed Companies and other specified companies. The definition of Independent Director is so complex that it will be difficult to find adequate number of persons to qualify as Independent Directors. Once appointed, they have to be ever vigilant about the activities of the company where they have accepted this assignment. As compared to their duties and responsibilities cast on them, many companies may not be able to adequately compensate them for the time and energy put in by them.

23.3 The task of three statutory committees viz. Audit Committee, Nomination and Remuneration Committee and Stakeholders relationship Committee will be onerous. Considering the functions of these committees, the Directors appointed to these committees will have to devote considerable time in making recommendations to the Board.

23.4 Internal Audit and Secretarial Audit has been given statutory recognition in the new Act. This will be over and above the financial audit and cost audit. The Directors will have to give due consideration to reports of the various auditors and ensure that the necessary explanation is given in the Board report in cases of qualifications or adverse remarks by the auditors.

23.5 Key Managerial Personnel such as CEO, CFO, Company Secretary etc. have to discharge the onerous duties and responsibilities cast in the new Act. They will have to be ever vigilant about the activities of the employees and other persons working for the Company. Considering their duties and responsibilities which they have to shoulder, companies will have to adequately compensate them.

23.6 Reading the above provisions it will be noticed that in respect of number of matters, the Central Government has to prescribe by Rules the limits for payments or procedure to be followed. Some draft rules have been published. We will have to wait for these rules to be finalized and determine the limits within which the Directors can operate. The directors

will have to constantly watch the amendments made in the Rules from time to time before taking any decision.

23.7 From the above provisions it will also be noticed that some stringent and minimum and maximum fines will be levied for contravention of these provisions. Punishment in the form of imprisonment of defaulting directors and Officers can also be awarded for such contravention of these provisions. Such provisions indicate that those in management are required to be vigilant about the compliance with provisions of the law and about Corporate Governance.

23.8 It appears that in enacting such stringent provisions the Government has taken care of some of the deficiencies of the existing Act and tried to remove the same. Further, an attempt is made to address the issues which have arisen in some cases of corporate failures and Corporate Scams which have so far come to light. Let us hope that the new Act, if properly implemented and administered brings more discipline in the matter of Corporate Governance in the years to come.

Annexure – I

CODE FOR INDEPENDENT DIRECTORS

This Code is a guide to professional conduct for independent directors. Adherence to these standards by independent directors and fulfillment of their responsibilities in a professional and faithful manner will promote confidence of the investment community, particularly minority shareholders, regulators and companies in the institution of independent directors.

1. Guidelines of professional conduct:

An independent director shall: (i) uphold ethical standards of integrity and probity, (ii) act objectively and constructively while exercising his duties; (iii) exercise his responsibilities in a bona fide manner in the interest of the company, (iv) devote sufficient time and attention to his professional obligations for informed and balanced

decision making: (v) not allow any extraneous considerations that will vitiate his exercise of objective independent judgment in the paramount interest of the company as a whole, while concurring in or dissenting from the collective judgement of the Board in its decision making; (vi) not abuse his position to the detriment of the company or its shareholders or for the purpose of gaining direct or indirect personal advantage or advantage for any associated person; (vii) refrain from any action that would lead to loss of his independence; (viii) where circumstances arise which make an independent director lose his independence, the independent director must immediately inform the Board accordingly; and (ix) assist the company in implementing the best corporate governance practices.

2. **Role and functions:**

The independent directors shall: (i) help in bringing an independent judgment to bear on the Board's deliberations especially on issues of strategy, performance, risk management, resources, key appointments and standards of conduct; (ii) bring an objective view in the evaluation of the performance of board and management; (iii) scrutinize the performance of management in meeting agreed goals and objectives and monitor the reporting of performance; (iv) satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible; (v) safeguard the interest of all stakeholders, particularly the minority shareholders; (vi) balance the conflicting interest of the stakeholders; (vii) determine appropriate levels of remuneration of executive directors, key managerial personnel and senior management and have a prime role in appointing and where necessary recommend removal of executive directors, key managerial personnel and senior management; and (viii) moderate and arbitrate in the interest of the company as a whole, in situations of conflict between management and shareholder's interest.

3. **Duties**

Independent directors shall

(i) undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company; (ii) seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice and opinion of outside experts at the expense of the company; (iii) strive to attend all meetings of the Board of Directors and the Board committees of which he is a member; (iv) participate constructively and actively in the committees of the Board in which they are chairpersons or members.(v) strive to attend the general meetings of the company; (vi) where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, insist that their concerns are recorded in the minutes of the Board meeting; (vii) keep themselves well informed about the company and the external environment in which it operates; (viii) not to unfairly obstruct the functioning of an otherwise proper Board or committee of the Board; (ix) pay sufficient attention and ensure that adequate deliberations are held before approving related party transactions and assure themselves that the same are in the interest of the company; (x) ascertain and ensure that the company has an adequate and functional vigil mechanism and to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use; (xi) report concerns about unethical behavior, actual or suspected fraud or violation of the company's code of conduct or ethics policy; (xii) acting within his authority, assist in protecting the legitimate interests of the company, shareholders and its employees; and (xiii) not disclose confidential information, including commercial secrets, technologies, advertising and sales promotion plans, unpublished price sensitive information, unless such disclosure is expressly approved by the Board or required by law.

4. Manner of Appointment:

(i) Appointment process of independent directors shall be independent of the company management; while selecting independent directors the Board shall ensure that there is appropriate balance of skills,

experience and knowledge in the Board so as to enable the Board to discharge its functions and duties effectively.

(ii) The appointment of independent director(s) of the company shall be approved the meeting of the shareholders.

(iii) The explanatory statement attached to the notice of the meeting for approving the appointment of independent director shall include a statement that in the opinion of the Board, the independent director proposed to be appointed fulfils the conditions specified in the Act and rules made there under and that the proposed director is independent of the management.

(iv) The appointment of independent directors shall be formalized through a letter of appointment, which shall set out: (a) the term of appointment; (b) the expectation of the Board from the appointed director; the Board-level committee(s) in which the director is expected to serve and its tasks; (c) the fiduciary duties that come with such an appointment along with accompanying liabilities; (d) provision for Directors and Officers(D and O) insurance, if any; (e) the Code of Business Ethics that the company expects its directors and employees to follow; (f) the list of actions that director should not do while functioning as such in the company; and (g) the remuneration, mentioning periodic fees, reimbursement of expenses for participation in the Boards and other meetings and profit related commission, if any. (v) The terms and conditions of appointment of independent directors shall be open for inspection at the registered office of the company by any member during normal business hours. (vi) The terms and conditions of appointment of independent directors shall also be posted on the company's website.

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(vi) The above terms and conditions shall also be posted on the company's website.

5. **Reappointment:**

The re-appointment of independent director shall be on the basis of report of performance evaluation.

6. **Resignation or removal:**

(i) The resignation or removal of an Independent director shall be in the same manner as is provided in sections 168 and 169 of the Act.

(ii) An independent director who resigns or is removed from the Board of the company shall be replaced by a new independent director within a period of not more than one hundred and eighty days from the date of such resignation or removal, as the case may be.

(iii) Where the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director shall not apply.

7. **Separate meetings:**

(i) The independent directors of the company shall hold at least one meeting in a year, without the attendance of non-independent directors and members of management;

(ii) All the independent directors of the company shall strive to be present at such meeting;

(iii) The meeting shall: (a) review the performance of non-independent directors and the Board as a whole; (b) review the performance of the Chairperson of the company, taking into account the views of executive directors and non executive directors; and (c) assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

8. **Evaluation of performance:**

(i) The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated.

(ii) On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.

Annexure II

Broad conditions for managerial remuneration specified in schedule V

I **PART – I: Conditions to be fulfilled for the appointment of a Managing or Whole – Time Director or Manager without approval of the Central Government:**

The conditions for such appointments are the same as in schedule XIII of the existing Act.

II **PART – II**

A. **Section I: Remuneration payable by companies having profits.**

Subject to the provisions of section 197, a company having profits in a financial year may pay remuneration to a managerial personnel not exceeding the limits specified in that section. This limit is 5% of net profit if the payment is to one person. If there are more than one persons, over all limit is 10% of net profit)

B. **Section II : Remuneration payable by companies having no profit or inadequate profit without Central Government approval.**

(i) Such remuneration shall not exceed the following limits.

Where effective capital is	Limit of yearly Remuneration
(a) Negative or less than Rs.5 cr.	30 lacs
(b) 5 cr. to 100 cr.	42 lacs

(c) 100 cr. to 250 cr.	60 Lacs
(d) 250 cr. and above	60 lacs plus 0.01% of the effective capital in excess of Rs.250 cr.

Note: The above limits will be doubled if the resolution passed by the shareholders is a special resolution.

(ii) If the managerial person is not a share holder, employee or director of the company at any time during the prior 2 years of his appointment, he can be paid remuneration @ 2.5% of the current relevant profit. If the person is appointed by a Special Resolution passed by the Share holders, he can be paid upto 5% of the current relevant profit.

Note: The above limits are applicable if –

(i) payment of remuneration is approved by a resolution passed by the Board and, in the case of a company covered under Section 178(1) also by the Nomination and Remuneration Committee;

(ii) the company has not made any default in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for continuous period of thirty days in the preceding financial year before the date of appointment of such managerial person;

(iii) a special resolution has been passed at the general meeting of the company for payment of remuneration for a period not exceeding three years.

(iv) A statement along with a notice calling the general meeting referred to in clause (iii) above is given to the shareholders containing the information listed in schedule V. This is similar to section II B of part II of schedule III of the existing Act.

C. Section III - **Remuneration payable by companies having no profit or inadequate profit without Central Government approval in certain special circumstances:**

(i) In the following circumstances a company may without the Central Government approval, pay remuneration to a managerial person in excess of the amounts provided in Section II above:-

(a) Where the remuneration in excess of the limits specified in section I or II is paid by any other company and that other company is either a foreign company or has got the approval of its shareholders in general meeting to make such payment, and treats this amount as managerial remuneration for the purpose of section 197 and the total managerial remuneration payable by such other company to its managerial persons including such amount or amounts is within permissible limits under section 197.

(b) Where the company –

(i) is a newly incorporated company, for a period of seven years from the date of its incorporation, or

(ii) is a sick company, for whom a scheme of revival or rehabilitation has been ordered by the Board for Industrial and Financial Reconstruction or National Company Law Tribunal, for a period of five years from the date of sanction of scheme of revival, it may pay remuneration up to two times the amount permissible under section II.

(c) Where remuneration of a managerial person exceeds the limits in section II but the remuneration has been fixed by the Board for Industrial and Financial Reconstruction or the National Company Law Tribunal:

Provided that the limits under this Section shall be applicable subject to meeting all the conditions specified under Section II and the following additional conditions:-

- Except as provided in para (a) of this Section, the managerial person is not receiving remuneration from any other company;

- The auditor or Company Secretary of the company or where the company has not appointed a Secretary, a Secretary in whole-time practice, certifies that all secured creditors and term lenders have stated in writing that they have no objection for the appointment of the managerial person as well as the quantum of remuneration and such certificate is filed along with the return as prescribed under sub-section (4) of section 196.
- The auditor or Company Secretary or where the company has not appointed a secretary, a secretary in whole-time practice certifies that there is no default on payments to any creditors, and all dues to deposit holders are being settled on time.

(d) company in a Special Economic Zone as notified by Department of commerce from time to time which has not raised any money by public issue of shares or debentures in India, and has not made any default in India in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of thirty days in any financial year, may pay remuneration up to Rs2,40,00,000 per annum.

D. Section IV – Perquisites not included in managerial remuneration:

A managerial person shall be eligible for the perquisites which shall not be included in the computation of the ceiling on remuneration specified in Section II and Section III above on the same lines as provided in schedule XIII of the existing Act with some modification.

E. **Notes** (i) Explanation I to V defines the following terms on the lines similar to provisions in schedule XIII of the existing Act.

- (a) Effective capital
- (b) Family
- (c) Role of Nomination and Remuneration Committee
- (d) Negative Effective Capital.

(ii) "Current Relevant Profit" is defined to mean profit calculated U/s 198, without deducting the expenditure over income referred to in Section 198 (4) (L) in respect of those years during which the managerial person was not an employee, director or shareholder of the company or its subsidiaries.

(iii) "Remuneration" means any money or its equivalent given or passed to any managerial person for services rendered by him and includes perquisites as defined under the Income tax Act and reimbursement of any direct taxes to such person

F. Section V. – Remuneration payable to a managerial person in two companies:

Subject to the provisions of sections I to IV above, a managerial person shall draw remuneration from one or both companies, provided that the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from any one of the companies of which he is a managerial person..

G. Notes:

(i) The appointment and remuneration referred to in Part I and Part II of this Schedule shall be subject to approval by a resolution of the shareholders in general meeting.

(ii) The auditor or the Secretary of the company or where the company is not required to appointed a Secretary, a Secretary in whole-time practice shall certify that the requirement of this Schedule have been complied with and such certificate shall be incorporated in the return filed with the Registrar under sub-section (4) of section 196.

The Central Government may, by notification, exempt any class or classes of companies from any of the requirements contained in this Schedule.