

## Companies Act, 2013

### Some issues requiring urgent actions /suitable amendments or clarifications

Sr. No.	Matter / Relevant Section/Rules	Issues Faced	Suggestions & justification
1	Relating to Funds raising & movement of funds to/from Company – Section 185	<p><b>Applicability of Section 185 to advances by Private Companies to entities in which Directors are Interested.</b></p> <p>S. 185 of the Act has provided some relief to Private Companies, wherein there are no corporate shareholders and the borrowings are not more than twice the share capital and free reserves or Rs.50 crs, whichever is less.</p> <p>This would still result in practical difficulties for private companies, which are of reasonable size and do not have access to institutional sources of funding.</p> <p><b>1956 Act:</b></p> <p>Erstwhile corresponding section 295 of 1956 Act was not applicable to private limited companies and hence provided flexibility to the entrepreneurs to utilise funds optimally.</p>	<p><b>Suggestions</b></p> <ol style="list-style-type: none"><li>1. The condition for relaxation of Section 185, regarding there being no corporate shareholders, needs to be removed, as this condition is not justified. To justify the removal of this condition, it would be appropriate to take into consideration the RBI's exemption to ICDs from the term Public Deposits.</li><li>2. The limit of borrowings should be increased to Rs.100 crs from current limit of Rs.50 crs, since entities with lesser quantum of borrowings can be treated as Non-PIE.</li></ol> <p><b>Justification</b></p> <ol style="list-style-type: none"><li>1. More often than not entrepreneurs operate through several private companies in the group, either because of regulatory requirements or for commercial exigencies. Freedom of funds movements within such group of private companies provides option to the entrepreneurs for optimum utilization of funds.</li><li>2. As such, Section 186 prescribes the overall limit and other terms such as rate of interest to govern lending</li></ol>

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			f loans and therefore, it is not likely to be prejudicial to the interest of the Company and stakeholders.
2	<p><b>Limits for giving Loans / Security / Guarantee or Making Investments – Section 186</b></p>	<p><b>Applicability of Section 186 to loan given to any person</b></p> <p>S. 186 of the Act intends to regulate loan by a Company to ‘any person’.</p> <p>‘Any Person’ would cover even individuals including employees of the Company. Accordingly, it put restriction on loan to employees beyond the specified limits</p> <p><b>1956 Act:</b></p> <p>Erstwhile corresponding section 372A of 1956 Act was also not applicable to loans &amp; advances to employees and it used to regulate only inter-corporate loans.</p> <p>Rule 11 of Chapter XII provides that where a loan or a guarantee has been given or where a security has been provided by a company to its wholly owned subsidiary(WOS) company or a joint venture company or acquisition is made by a holding company by way of subscription, purchase or otherwise of, the security of its WOS, the requirement of passing special resolution in general meeting will not apply</p>	<p><b>Suggestions</b></p> <p>S 186 should not be made applicable to loans&amp; advances to employees or if required, the maximum limit of such loans (linked to salary) can be prescribed, say as per the general rules applicable to the company or 5 years of current salary drawn by the employee</p> <p><b>Justification</b></p> <p>The intent of S 186 is not to restrict the loans and advances given to employees in the ordinary course of business</p> <p><b>Suggestions</b></p> <ol style="list-style-type: none"> <li>1. The similar exemption should be extended even to other than wholly owned subsidiary, in addition to WOS and joint venture company.</li> <li>2. Other terms of section 186 and 188 like arm’s length and minimum interest rate should also be exempted for transactions with the WOS as it does not impact the economic interest of the shareholders of the holding company, in any way.</li> <li>3. We suggest that any provisions of Section 186 should not be applicable to WOS, instead of exemptions from certain sub-sections.</li> </ol>

3	<p><b>Rotation of auditors – Section 139</b></p>	<p>The following class of companies cannot appoint or re-appoint an audit firm as auditor for more than two terms of five consecutive years:</p> <ul style="list-style-type: none"> <li>(a) all listed companies;</li> <li>(b) all unlisted public companies having paid up share capital of rupees ten crore or more;</li> <li>(c) all private limited companies having paid up share capital of rupees twenty crore or more;</li> <li>(d) all companies having paid up share capital of below threshold limit mentioned in (b) and (c) above, but having public borrowings from financial institutions, banks or public deposits of rupees fifty crores or more.</li> </ul> <p><b>Issues:</b></p> <ul style="list-style-type: none"> <li>(a) Globally in countries where auditor rotation is mandated, it is applicable only to listed entities or public interest entities like banking and insurance companies.</li> <li>(b) The threshold for auditor rotation in India has been kept extremely low, as a result of which, even small unlisted public companies as well as private companies with no public exposure will also have to search for new auditors immediately. This will pose immense practical difficulties for these companies.</li> </ul>	<p><b>Suggestions</b></p> <ol style="list-style-type: none"> <li>1. Audit Rotation should be restricted to listed entities and public interest entities (banks, insurance companies, public financial institutions) in line with international practices.</li> <li>2. If at all rotation is mandated for unlisted public companies or private companies, the thresholds of paid up share capital should be increased to Rs. 50 crores and threshold of public borrowings and public deposits should be increased to at least Rs.100 crores.</li> </ol>
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		relative or partner – is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company.	<ol style="list-style-type: none"> <li>1. Only Auditors of holding company should have restriction of holding securities of Holding company and its subsidiaries/associates. The reason being the said Auditor will be opining on consolidated financial statements of the group which includes subsidiaries and associates.</li> <li>2. There should not be any restrictions on holding securities of holding company for auditors of subsidiaries/associates, as the said auditors will be opining only on standalone financial statements of subsidiary / associate company which he is auditing. The said Auditors is not likely to have any access to the records of the holding company.</li> </ol>
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6	<b>Section 141 (3) (i) in respect of non eligibility of the person for appointment as an Auditor</b>	<p>The sub-section provides that any person whose subsidiary or associate company or any other form of entity is engaged in consulting and specified services cannot be appointed as an Auditor of a company.</p> <p>A literal meaning of the provisions is that if a firm or its other affiliated entities are providing consulting or any specified services then that firm cannot act as an Auditor of any company.</p>	<p>The intention seem to be to restrict appointment of Auditor to a particular company if the said person or its affiliated entities are engaged in providing consulting or other specified services (u/s 144) to that particular company.</p> <p>We suggest that language should be modified or rules should be provided to clarify the above intention, so that the restriction applied only vis-a-vis a particular company to whom specified services are rendered.</p>
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7	<p><b>Eligibility for appointment as an auditor of a company – Section 141(3)(e) read with Rule 10 of the Companies (Audit &amp; Auditors) Rules, 2014</b></p>	<p><b><u>Business relationships</u></b>  As per section 141(3)(e) - A person or firm shall not be eligible for appointment as an auditor, if such person/firm, directly or indirectly, has business relationship with the company, its subsidiary, its holding, or associate company or subsidiary of such holding company or associate company.</p> <p>The term “business relationship” has been defined in the Rule 10(4) - to include any commercial transaction except i) professional services permitted to be rendered by an auditor and ii) commercial transactions which are in the ordinary course of business of the company at arm’s length price, like sale of products or services to the auditor as customer in the ordinary course of business, by companies engaged in the business of telecommunication, airlines, hospitals, hotels and <u>such other similar businesses.</u></p> <p>The term ‘such other similar businesses’ has not been defined and if it’s literal meaning is considered, then only the businesses of the type mentioned in the rule, would have to be taken into account. This may have serious negative impact on the appointment criteria and qualifications of the auditor. For example: the auditor may be disqualified if he/she purchases computers/printers from the company owned outlets of the auditee</p>	<p>1. It cannot be the intention to restrict the businesses to those similar to the ones provided as guidance. Hence the rule should accordingly be modified to replace such term with ‘any other businesses’. That is any transactions in the ordinary course of business and is at arm’s length with the auditee company should be permitted.</p>
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8	<b>Other Services which cannot be rendered by Auditors – Section 144</b>	U/s. 144, the auditors of the Company have been prohibited from providing certain specified services to the company. One of such prohibited services is 'Management Services'. This term is not defined in the Act or Rules.	<p><b>Suggestions</b></p> <ol style="list-style-type: none"> <li>1. Term 'Management Services' should be clearly and unambiguously defined in the Act or Rules so that compliance thereof by Auditors and Companies gets facilitated.</li> </ol>
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9	<b>Reporting on internal financial controls – Section 143(3)(i)</b>	<p><b>Provision Summary</b></p> <ol style="list-style-type: none"> <li>1. The auditor has to now additionally state in his report whether the company has adequate <b>internal financial controls system</b> in place and the operating effectiveness of such controls.</li> <li>2. Directors of listed Companies have to report on the adequacy &amp; effectiveness of IFC in their responsibility statement. Explanation to S. 134(5)(e) defines IFC in wider manner to mean policies &amp; procedures adopted by the Company for ensuring orderly and efficient conduct of its business, safeguarding its assets, prevention &amp; detection of frauds &amp; errors, accuracy &amp; completeness of accounting records and timely preparation of reliable financial information.</li> <li>1. In case of Co.’s other than Listed Companies – Board report is required to include ‘details in respect of adequacy of internal financial controls with reference to the Financial Statements’.</li> </ol>	<p><b>Suggestions</b></p> <p>Under S. 143(3)(i) w.r.t. to reporting on IFC should be confined to Financial Reporting only and it should not be extended to any other operations of the company. We suggest that words ‘operating effectiveness of such controls’ should be deleted.</p> <p><b>Justification</b></p> <p>Following interpretations emerge from the provisions:</p> <ol style="list-style-type: none"> <li>1. In case of Companies other than listed, the Board report is required to contain details of IFC w.r.t. Financial Statements (‘FS’) whereas the auditors are expected to comment on adequacy &amp; effectiveness of IFC (not necessarily confined w.r.t. FS). The reporting requirement of auditors is far exceeding the Responsibility of the Company / Management.</li> <li>2. Auditors are not involved in day-to-day affairs of the company and hence it is not possible for the auditors to comment on operating effectiveness.</li> </ol>

10	<b>Reporting on fraud – Section 143(12)</b>	<p>Provisions of Section 143(12) puts an onerous responsibility on the Auditors to report to the Central Government, if in the course of audit – he has ‘<b>reason to believe</b>’ that an offence involving fraud has been or ‘<b>is being committed</b>’ against the company by the officers or the employees.</p> <p>The draft rules contained the materiality levels for such reporting as incidents having impact of 2% of turnover or 5% of net profit of the Company.</p> <p>The Companies (Amendment) Act, 2015, has now restricted the reporting to Central Government for frauds involving amount beyond specified limit. However, currently there is no materiality level prescribed through Rules.</p>	<p><b>Suggestions</b></p> <ol style="list-style-type: none"> <li>1. In a normal business, there can be allegations, which are at various stages of investigations. Consequently, reporting requirement for the auditor should only be limited to those frauds which have been investigated and concluded and not merely allegations.</li> <li>2. The reporting should be restricted only to the material frauds and the materiality thresholds as contained in the draft rules may be prescribed.</li> <li>3. The words ‘has reason to believe’ connote use of judgment in the course of audit which may eventually not be concluded as fraud and hence such type of reporting should not be prescribed.</li> </ol> <p><b>Suggestions</b></p> <p>Since materiality level for reporting to Central Government has not yet been prescribed, it would be advisable to make the reporting for frauds applicable to Financial Year 2016-17 and onwards.</p>
11	<b>Companies (Audit &amp; Auditors) Rules, 2014</b>	<p>The auditors are required to include in their report of their views &amp; comments on:</p> <ol style="list-style-type: none"> <li>(i) whether company has disclosed the impact, if any, of pending litigations in its FS;</li> <li>(ii) whether the company has made provision required under any law or Accounting Standards (AS) for material foreseeable</li> </ol>	<p><b>Suggestions</b></p> <p>These items are being adequately dealt with by the respective Accounting Standards and hence the same should be removed from the reporting requirements</p> <p><b>Justification</b></p>

		losses, if any, on long term contracts including derivatives	The items mentioned above are covered by provisions of AS 1, AS 7, AS-29, etc. and auditors are expected to consider the compliance while reporting.
12	<b>Definition of free reserves – S 2(43)</b>	<p>Definition of free reserves – S 2(43)</p> <p>The definition intends to exclude unrealized gains, notional gains as also fair value changes recognised in the statement of profit and loss.</p>	<p><b>Suggestions</b></p> <p>It may be noted that unrealized gains in respect of foreign currency, monetary assets and liabilities or fair value change under specific regulations, etc. are necessarily part of FS and exclusion thereof does not seem appropriate. It will be very difficult to keep track of such unrealised gains which has been recognised in the statement of profit and loss in the normal course, in line with the applicable accounting standards.</p>
13	<p><b>Chapter III- Prospectus and Allotment of Securities</b></p> <p><b>Chapter IV- Share Capital and Debentures</b></p>	Transitional provisions in respect of continuation of various actions initiated and taken under the Companies Act 1956.	<p><b>Suggestions</b></p> <p>Any action taken prior to notification of section under the Companies Act 2013 in respect of issue of shares, buyback or offer for sale shall continue to be governed by the provisions of the Companies Act 1956.</p>
14	<b>Powers of NFRA – To make order for Professional or other misconduct by the member/firm – Section 132 (4) (c)</b>	This section states, where professional or other misconduct is proved, NFRA has the power to make order for debarring the member or the firm from practice for 6 months to 10 years.	<p><b>Suggestion</b></p> <p>There should be clarification through Rules that the entire firm shall not be debarred unless majority of the partners including the firm’s leadership directly and substantially participated in the misconduct. Further, the manner in which the investigation shall be carried out before deciding any</p>

			person as guilty of professional misconduct has not been prescribed, which should be done.
15	<b>Section 118(10)</b>  <b>Secretarial Standards</b> <b>SS-1 – Meetings of the Board of Directors</b> <b>SS-2- General Meetings</b>	The applicability of the Secretarial Standards to all companies except One Person Company (OPC) casts excessive compliance burden especially to private limited companies.	<b>Suggestions</b> The private limited companies having paid up capital less than Rs.5 Crores should be exempted from this compliance.  <b>Justification</b> Such companies are not mandated to appoint Company Secretary under section 203 of the Companies Act 2013 and hence it does not have the necessary resources to comply with the standards.
16	<b>Section 62 (1) (c) and Rule 13 of the Companies (Share Capital and Debentures) Rules, 2014- Further issue of share capital</b>	These provisions when read with provisions of section 42 cast undue hardships in terms of compliance and disclosure in respect of further issue of shares by a private company.  <b>1956 Act:</b> Erstwhile corresponding section 81 of the 1956 Act which deals with further issue of share capital, these provisions were not applicable to the Private Company	<b>Suggestions</b> A private company should be exempted from compliance under Section 42 pertaining to subscription of securities on private placement basis, in line with Section 81 of the 1956 Act.

**General –**

1. It is suggested to have a specified period of at least one year for transitional period to comply with the various provisions of the Companies Act 2013 which are new provisions / changed provisions vis a vis provisions of the 1956 Act to avoid non-compliance / hardship of immediate compliance.
2. The penalties and prosecution against Auditors under the provisions of the Companies Act 2013 are quite harsh and need to be reconsidered and moderated.