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Highlights of Standing Committee Report on Companies Bill, 2011

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The Parliamentary Standing Committee on Finance (the "Committee") had earlier examined the Companies Bill 2009 ("Bill 2009") and presented report on the same in the Parliament on 31 August, 2010. Keeping in view the recommendations made by the Committee, a revised Companies Bill 2011 ("Bill 2011") was prepared by the Ministry of Corporate Affairs (MCA). Now, the report of the Committee on the Bill 2011 has been presented in the Parliament on June 26, 2012. Most of the provisions of the Bill 2011 have been recommended by the Committee.

The most welcoming recommendation of the Committee is to mandate the provisions relating to corporates to spend on Corporate Social Responsibilities (CSR) which, if approved by the Lok Sabha, would be the first law to make such expenditure mandatory. Maintenance and allowing inspection of documents by companies in electronic form is also being introduced in the Bill 2011.

Among the other recommendations, an effort has been made to streamline the liability of directors and officers. Whole-time directors are now to be included in the definition of "key managerial personnel" irrespective of whether the company has a managing director or not. The Committee has called for limiting criminal liability for mere technical infraction of the company law provisions. This surely comes as a relief to all. Most of the show cause notice during the inspection u/s 209A of the Act was related to such technical offences. Companies had to pay huge compounding fees for such offences of a minor nature. Seems that the Committee has also realised that the nature of offence is more important nowdays than to go into mere technicalities.

Other important recommendations include the manner and method of appointment of auditors, the duration of appointment, rotation of audit firms and audit partners, constitution of the National Company Law Tribunal (and whether it should include members of the Company Law Board), exemptions to private companies from certain provisions of the Act, and consolidation and subdivision of capital.

Below, is a synopsis of some of the important recommendations of the Committee:

Mandatory CSR

The report says that companies with net worth above Rs 500 crore or an annual turnover of over Rs 1,000 crore or a net profit of Rs 5 crore or more will have to earmark two per cent of their average net profits of three years toward CSR. The Bill 2011 under Clause 135 makes such expenditure mandatory and has prescribed that such company is also required to form a separate committee for CSR comprising of atleast three directors one of whom should be an independent director. *Disclosure is mandatory in the Board's Report*. An indicative Schedule of CSR activities has also been appended to the Bill with power to add or remove any of the items mentioned therein.

In the Bill 2009, the CSR clause was included for the first time, but it only was only an optional provision for companies to under CSR and made it mandatory for all companies to disclose their CSR spends to shareholders.

Governance in Government Companies

The Committee has called for a disclosure in the report of the board of directors of a government company indicating the impact / implications of Government directives on the financial position of such company. However, MCA is having a different view in this regard. According to MCA, large number of disclosures have already been provided for inclusion in the Board's report and adding further requirements for a particular class of companies in a general enactment will be burdensome for such companies.

This is a new move of the Committee not included in Bill 2009 and is a welcoming step as it would induce greater transparency in the functioning of government companies and is an important step in the context of the government's proposal to divest shares to the public in several other public sector companies.

Recommendations relating to auditors

Rotation of auditors/firm

The Committee has proposed that appointment of auditors should be considered in every 3 years instead of 5 years period as mentioned in the Bill 2011. Presently, re-appointment is required to be made every year under the Companies Act, 1956. Proposal for rotation of audit partners has been made by the Committee against the existing provision in Bill 2011 requiring rotation of audit firm. However, MCA has pitched on the existing clause of rotation of audit firms only.

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Appointment/removal of auditors

The Committee's view is that both the appointment and removal of auditors should require audit committee's recommendations unlike in the Bill 2011, where audit committee needs to perform its function at the time of appointment only.

Liability of auditors

Another major recommendation of the Committee in this behalf is that only the partner in default should be made liable and not the whole firm or LLP of the auditors. However, MCA is happy with the existing Clause 140 in the Bill 2011 making the whole firm or LLP liable and has noted this recommendation for changes, if required to be made in future.

Definition of 'business relationship'

The nature of 'business relationship' has been prescribed by the Committee which has been noted by the MCA for incorporating in the Rules to be issued in this regard.

Remuneration of auditors

The recommendation of the Committee to re-word the existing Clause 142 of the Bill 2011 to empower the board to fix the remuneration in case of first auditors has been accepted by the MCA. The said clause prescribed that the authority to fix the remuneration of the auditors including the first auditors shall be with the members.

Flexible provisions for private companies

Exemption to private companies has been recommended from the restrictions imposed as regards types of share capital and voting to provide flexibility. However, the same has been answered by the MCA stating that Clause 462 of the Bill 2011 empowers the government to exempt certain class of companies from the requirements of any provision of the law, hence the issue can be dealt by issuing specific orders as and when required.

Similar provision as recommended by the Committee exists in Companies Act, unfortunately, the same was neither considered in Bill 2009 nor in Bill 2011.

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Companies having its equity listed on stock exchanges to be called listed company

"Listed Companies" as per the Companies act, 1956 mean companies whose ***any of the securities are listed*** on any recognized stock exchange. However, the Committee has recommended alteration in the definition to include such companies which has its equity shares listed on any recognized stock exchange. The Bill 2009 as well as the Bill 2011 included the same definition as mentioned the Companies Act.

The said recommendation of the Committee, if accepted, would mean the companies can have their securities other than equity listed on stock exchanges and still can enjoy the status of an unlisted company, thus not required to make various compliances. To an extent it is relaxation of control

Exemption to unlisted companies from internal audit

The Committee proposed to exempt the unlisted companies from the requirement of internal audit which is mandatory in terms of Clause 138(1) of the Bill 2011 for certain class of companies as may be notified from time to time. The MCA has fixed its seal of approval to this recommendation and the same shall be included in the rules to be framed for the said clause. Though not really understood as to why this exemption has at all been recommended. The only factor beneficial is the cost. Rest though not a listed entity but there was accountability and transparency. On the other hand it can also be seen as a welcoming provision.

Offering Securities

The Bill, 2011 significantly tightened the process for offering securities, particularly to a large number of investors. Specifically, the Committee has asked for a specific definition of "private placement". Further, it has sought to limit the definition of a "listed company" and "securities". The report states:

> "It has been suggested that with a view to accord some freedom and flexibility of operations to Companies, specially when public funds are not involved, the above definition may be amended to limit the applicability only to: (a) Companies where the equity shares or any security convertible into equity shares are listed; or (b) companies where the debt instruments are listed, having been issued to public at large. The Committee find merit in the

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> argument from operational perspective that the scope of above definition of "Listed Company" may be confined to listed securities issued through the process of "Public offer" [as defined in clause 23(1)] only, so that the regulatory framework can focus on such instruments only without dissipating energy and resources on all kinds of instruments, since the unlisted instruments are already subject to scrutiny of Ministry of Corporate Affairs. The Ministry of Corporate Affairs may accordingly consider appropriate modification in the definition of "Listed Company" in consultation with Ministry of Finance."

Clearly, the preference seems to be economic efficiency for the corporate sector by providing access to financing, which results in limited investor protection. Again, the Committee seeks to redraw the lines placed by the Bill 2011.

Conclusion

The Bill, first introduced in the Lok Sabha in 2008, lapsed after the dissolution of the 14th Lok Sabha. It was reintroduced in August 2009, with the Committee giving its recommendations in 2010. The Government had tabled the revised Bill in 2011, but the Committee had said it should be considered again, claiming many provisions in the revised Bill were new, and it had not deliberated on these.

On a quick review of these new recommendations of the Committee, it seems that MCA has not accepted the new recommendations on the ground that the same were not given earlier. Some of the recommendations have been commented by MCA in a diplomatic way giving assurance that recommendations would be included in rules to be drafted by the MCA from time to time.

Overall, the recommendations are few in number but some are controversial. However, the approach of the MCA might not be very welcoming