As we start 2018, it seems like a good time to consider the Companies Act, 2013 (2013 Act) and the impact that it has had thus far on the corporate world. The Ministry of Corporate Affairs (MCA) has been open to engage with and listen to the genuine concerns and grievances of stakeholders. It formed the Companies Law Committee (CLC) which deliberated on the concerns and suggestions of the stakeholders and provided its recommendations in February 2016.

Over the past three years, MCA has issued a number of amendments and clarifications to various sections and rules of the 2013 Act. The recent changes to the 2013 Act brought out by the Companies (Amendment) Act, 2017 received the President’s assent on 3 January 2018. Various changes made by the Companies (Amendment) Act, 2017 are in line with the CLC recommendations and are likely to improve the ease of doing business in India.

Therefore, this month’s issue of the Accounting and Auditing Update (AAU) contains an updated compilation of our articles over the last year on the key aspects of the 2013 Act. These articles include clarifications and implementation related insights that have been gained as companies have sought to apply in practice this legislation, including changes made by the Companies (Amendment) Act, 2017.

The process of change to the 2013 Act is not over yet, companies should expect notifications on the various sections of the Companies (Amendment) Act, 2017 and related rules in the coming months. Accordingly, the impact of the rules read along with the Companies (Amendment) Act, 2017 would need to be analysed further.

Our articles on the Companies Act also highlight at relevant places the requirements of the Securities and Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirements) Regulations, 2015 that are applicable to listed entities in India.

As is the case each month, we also cover a regular round-up of some recent regulatory updates in India and internationally.

We would be delighted to receive feedback/suggestions from you on the topics we should cover in the forthcoming editions of AAU.
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The Companies Act, 2013

The Companies Act, 2013 (2013 Act) has been operationalised by the Ministry of Corporate Affairs (MCA) from 1 April 2014. Since its introduction, MCA has issued a number of amendments and clarifications to various sections and rules in the 2013 Act.

On 3 January 2018, the Companies (Amendment) Act, 2017 received the assent of the President of India. The Companies (Amendment) Act, 2017 makes significant changes to the 2013 Act which aim at ease of doing business, better corporate governance and enforcement of stringent penal provisions for defaulting companies.

The Companies (Amendment) Act, 2017 will come into effect on such date as the Central Government (CG) may, by notification in the Official Gazette, appoint. Different dates may be appointed for different provisions of the 2013 Act and any reference in any provision to the commencement of the 2013 Act should be construed as a reference to the coming into force of that provision.

The MCA through a notification (no. S.O. 351(E)) dated 23 January 2018 notified Section 1 of the Companies (Amendment) Act, 2017 and Section 4 (relating to reservation of name of a company) with effect from 26 January 2018.

This month’s issue of the Accounting and Auditing Update (AAU) focusses on the 2013 Act and highlights the key changes made by the Companies (Amendment) Act, 2017. Additionally, we highlight the relevant key requirements of the Securities Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) applicable to listed entities in India.

Key provisions of the 2013 Act could be divided in the following areas:

- Financial reporting - Accounts of companies
- Related party transactions
- Corporate Social Responsibility (CSR)
- Acceptance of deposits
- Role and responsibilities of directors
- Declaration and payment of dividend
- Loans and investments by companies
- Audit and auditors
- Restructuring of companies
- Private companies – relaxations under the 2013 Act.
The 2013 Act incorporates the leading industry practices as far as the financial reporting by the companies is concerned. In this chapter, we aim to provide an overview of the key provisions of the 2013 Act and the related Rules with respect to the preparation of consolidated financial statements by the companies with subsidiaries/associates/joint ventures, cash flow statement as part of financial statements, accounting of depreciation, requirement relating to uniform accounting year, mandatory reporting on Internal Financial Controls (IFC) and internal audit.

Consolidated Financial Statements (CFS)

The 2013 Act mandates that the Board of Directors (BoD) of every company are required to lay financial statements (stand-alone and CFS) prepared for every Financial Year (FY) at every Annual General Meeting (AGM) of the company. The CFS would be prepared by a company including unlisted company that has one or more subsidiaries or associate companies. Previously, SEBI required only listed companies to prepare CFS. A company would prepare CFS in addition to the stand-alone financial statements and the MCA has clarified that Schedule III to the 2013 Act does not envisage that a company while preparing its CFS should repeat the disclosures made by it in the stand-alone financial statements. In the CFS, the company would need to give all disclosures relevant to CFS. The 2013 Act requires that CFS should be prepared even for companies that do not have any subsidiary(ies) but have investment in associates and/or joint ventures. Additionally, Ind AS 110, Consolidated Financial Statements also mandates that CFS should be prepared by a parent that does not have subsidiary but has investment in associates and joint ventures.

On the other hand, Accounting Standard (AS) 21, Consolidated Financial Statements did not require a company with no subsidiaries but with investments in associates and joint ventures to prepare CFS. On 30 March 2016, MCA amended AS 21 to ensure that there is no inconsistency between the 2013 Act and AS. Therefore, AS 21 (amended) too requires a company that does not have a subsidiary but has an investment in an associate and/or a joint venture to prepare CFS².

Requirements prescribed under the Listing Regulations

The Listing Regulations prescribe following in relation to preparation and filing of financial results for equity and debt listed entities.

- **Financial results to be submitted**: Following financial results are to be submitted as per the Listing Regulations:

  **Equity listed entities (Regulation 33)**

  a. **Quarterly and Year-To-Date (YTD) consolidated financial results**: Every equity listed entity should submit quarterly/YTD stand-alone financial results within 45 days of the end of each quarter to the recognised stock exchange(s). These quarterly and YTD financial results need to be either reviewed or audited by the auditors.

  Additionally, a listed entity with subsidiaries could submit consolidated quarterly/YTD financial results along with the stand-alone financial results. The listed entity should intimate to the stock exchange whether or not it opts to additionally submit quarterly/YTD consolidated financial results in the first quarter of the FY and this option should not be changed during the FY.

  In case of change of option, comparatives for the Previous Year (PY) in accordance with the option exercised for the current FY to be given.

  b. **Annual audited consolidated results**: Equity listed entities are also required to submit annual audited stand-alone financial results and annual audited consolidated financial results along with the audit report and Statement on Impact of Audit Qualifications (applicable only in case of an audit report with modified opinion) within 60 days from the end of the FY. In case of an audit report with an unmodified opinion, a declaration of the fact should be submitted by the entity to the stock exchange while publishing the results.

  **Debt listed entities (Regulation 52)**

  a. **Half-yearly financial results**: Debt listed entities are required to prepare and submit audited/ unaudited financial results on a half-yearly basis within 45 days from the end of the half-year to the recognised stock exchange.

  Unaudited financial results are to be accompanied by limited review report. Further, if the listed entity opts to submit unaudited financial results for the last half-year accompanied by limited review report by the auditors, audited financial results for the entire FY should also be submitted as soon as they are approved by BoD.

  b. **Annual audited results**: Debt listed entities are required to submit annual audited financial results along with the annual report and Statement on Impact of Audit Qualifications (applicable only in case of an audit report with modified opinion) within 45 days from the end of the FY.

  In case the debt listed entity intimates in advance to the stock exchange that it would submit its annual audited results within 60 days from the end of the FY, then unaudited results for the last half-year accompanied by limited review report need not be submitted to the stock exchange(s).

- **Companies following Ind AS**: In the first-year of Ind AS implementation, SEBI has provided certain relaxations to listed (equity or debt) entities falling under both phase I and II of the Ind AS road map to facilitate smooth transition to submit their financial results prepared on the basis of the Ind AS. For a detailed overview of the relaxations, please refer to Annexure I of this publication.

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Companies exempt from preparation of CFS

Initially, the way 2013 Act was written, there was no exemption from preparation of CFS similar to International Financial Reporting Standards (IFRS) for the intermediate holding companies if the ultimate parent company prepares CFS that are publicly available. In a multi-layered structure, this requirement would have led to preparation of CFS at multiple levels of companies. The Companies (Accounts) Rules, 2014 (Accounts Rules) exempt the following companies from the preparation of CFS:

a. An intermediate parent company which meets the following conditions:
   i. It is a wholly-owned subsidiary, or is a partially-owned subsidiary of another company and all its other members (including those not otherwise entitled to vote) have been intimated in writing and for which the proof of delivery of such an intimation is available with the company, do not object to the company not presenting CFS
   ii. It is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India, and
   iii. Its ultimate or any intermediate holding company files CFS with the Registrar of Companies (ROC) which are in compliance with the applicable AS.

These conditions are similar to the conditions specified under Ind AS 110. However, the Rules do not grant an exemption to the partially-owned companies or wholly-owned subsidiaries of foreign companies in India.

Revised definition of subsidiary as per the Companies (Amendment) Act, 2017

Subsidiary company or subsidiary in relation to any other company (i.e. the holding company), means a company in which the holding company:

i. Controls the composition of BoD or
ii. Exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies.

A holding company can create up to two layers of subsidiaries only. However, one layer which consists of one or more wholly-owned subsidiary or subsidiaries would not be taken into account for computing the number of layers.

Requirements prescribed under the Listing Regulations

Every listed company is mandatorily required to prepare CFS under the Listing Regulations (there is no exemption for an intermediate-listed company).

Definition of a subsidiary, associate, joint venture

The definition of what constitutes a subsidiary, associate or joint venture are not aligned between current AS/Ind AS and the 2013 Act. For instance:

**Subsidiary**

As per AS 21, subsidiary means an enterprise that is controlled by another enterprise (known as the parent), where control is defined to mean:

a. The ownership, directly or indirectly through subsidiary(ies), of more than one-half of the voting power of an enterprise or

b. Control of the composition of BoD in the case of a company or of the composition of the corresponding governing body in case of any other enterprise so as to obtain economic benefits from its activities.

In many cases, the total voting power would be with reference to equity share capital. However, if dividend in respect of a class of preference shares has not been paid for a period of two years or more, then such class of preference shareholders would also have right to vote on the resolutions placed before the company.

According to the 2013 Act, control of more than ‘one-half of the total voting power’ is the deciding factor for a relationship of a holding and a subsidiary company. However, Ind AS 110 has a detailed definition of control which states that an investor has power over the investee, exposure or rights, to variable returns from its involvement with the investee and has the ability to use its power over the investee to the amount of investor’s returns. Under Ind AS, a parent could control an entity either through voting rights, other contractual arrangements, or could exercise de facto control.

**Associate**

As per AS 23, Accounting for Investments in Associates in Consolidated Financial Statements, an associate is defined as an enterprise in which the investor has significant influence and which is **neither a subsidiary nor a joint venture** of the investor.

Under Ind AS 28, Investments in Associates and Joint Ventures, an associate is an entity over which the investor has significant influence.
While considering a relationship for being an associate company, shares held by a company in another company in a 'fiduciary capacity' would not be counted for the purpose of determining the relationship of an 'associate company'.

**Joint venture**

The 2013 Act did not define the term 'joint venture' and made reference to joint venture as an inclusive part in the definition of the term 'associate company'.

**Meaning of joint venture as per the Companies (Amendment) Act, 2017**

The Companies (Amendment) Act, 2017 continues to refer joint venture within the term associate company but also defines joint venture.

According to it, joint venture means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the management.

The above given definition is in line with Ind AS 28, Investments in Associates and Joint Ventures.

However, Ind AS 28 further defines the terms ‘joint arrangement’ and ‘joint control’ which are associated with the definition of joint venture. While the Companies (Amendment) Act, 2017 does not include these definitions, we believe that the intent of the law has been to align the definition of joint venture with Ind AS and therefore, the two associated definitions of joint control and joint arrangement could be read harmoniously with Ind AS.

As per AS 27, Financial Reporting of Interests in Joint Ventures, a joint venture is a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control.

**Alignment of definitions**

The MCA addressed the situation where the definitions of the 2013 Act and AS/Ind AS may not be aligned in all cases. Accordingly, the MCA amended the Accounts Rules to provide that the financial statements of a company should be in a form specified in Schedule III to the 2013 Act and should comply with AS or Ind AS, as applicable. Therefore, the items contained in the financial statements should be prepared in accordance with the definitions and other requirements as specified in the AS/Ind AS, as the case may be.

**Meaning of subsidiary, associate and joint venture as per the Listing Regulations**

As per the Listing Regulations:

- **Subsidiary** means a subsidiary as defined under Section 2(87) of the 2013 Act.
- An associate means any entity which is an associate under the 2013 Act or under the applicable AS. However, this definition would not be applicable for the units issued by mutual fund which are listed on a recognised stock exchange(s) for which the provisions of the SEBI (Mutual Funds) Regulations, 1996 would be applicable.

**Disclosures**

Financial statements (including CFS) of a company should be prepared in accordance with Schedule III to the 2013 Act (Section 129(1)) and should be approved by BoD of the company (Section 134(1) of the 2013 Act). Additionally, following statements should be attached to the financial statements:

a. An auditors’ report
b. Report by BoD which, *inter alia*, includes the Directors’ Responsibility Statement.

Further, Rule 12(1) of the Accounts Rules require that every company should file the stand-alone financial statements with the ROC together with Form AOC-4 and CFS with Form AOC-4 CFS. Statement containing the salient feature of the financial statements of a company’s subsidiary(ies), associate company(ies) and joint venture(s) should be filed in Form AOC-1 as per Rule 5 of the Accounts Rules.

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Relaxations from disclosures under the Companies (Amendment) Act, 2017

- **Listed companies to place separate audited accounts of subsidiary on website:** Only listed companies with a subsidiary(ies) should place separate audited accounts in respect of each of its subsidiary on its website.

- **Placement of separate audited accounts of overseas subsidiaries:** For foreign subsidiary(ies) of the Indian holding company, separate audited accounts of such foreign subsidiary(ies) is not required to be placed on its website. Instead, the holding company should place CFS of the foreign subsidiary(ies) as per the laws of the country in which they have been incorporated on its website.

In case the foreign subsidiary is not required to get its financial statements audited under the laws of the country of its incorporation, then the holding company could place such unaudited financial statements on its website (along with a translated copy of the financial statements (in case they are in language other than English)).

Cash flow statements

Under the 2013 Act, all companies are required to provide cash flow statements as part of their financial statements. However, exemption from preparation of cash flow statement is provided to small, one person, dormant and private companies which are start-up7 companies.

Requirements prescribed under the Listing Regulations

- The annual report of every listed entity (equity as well as debt) should include its cash flow statement.

- A cash flow statement should be presented only under the indirect method as prescribed in AS 3, *Cash Flow Statements* or Ind AS 7, *Statement of Cash Flows* mandated under Section 133 of the 2013 Act read with relevant rules framed thereunder or as specified by the Institute of Chartered Accountants of India (ICAI), whichever is applicable.

Accounting of depreciation

Under the 2013 Act, depreciation accounting assumes a new order i.e. specifies indicative rates of depreciation and requires management to exercise judgement in arriving at rates for depreciation based on the expected usage pattern of assets.

Section 123 of the 2013 Act requires that a company should declare or pay dividends out of the profits of the company for that year which is arrived at after providing for depreciation in accordance with Schedule II to the 2013 Act (Schedule II). Similarly, for payment of managerial remuneration to the directors, net profits are to be computed after deducting the amount of depreciation calculated in accordance with Section 123 of the 2013 Act.

Therefore, Section 123 and Schedule II lay down the requirements for depreciation under the 2013 Act.

To help understand the requirements of the Schedule II, ICAI has issued a guidance note (Guidance Note on Accounting for Depreciation in Companies in the context of Schedule II to the 2013 Act) in February 2016. Additionally, ICAI has issued an educational material on the Ind AS 16, *Property, Plant and Equipment* which highlights the key requirements of the standard and the Frequently Asked Questions (FAQs) covering the issues which are expected to be encountered frequently while implementing the standard.

It is important to note that ICAI issued a revised AS 10, *Property, Plant and Equipment* and withdrew AS 6, *Depreciation Accounting*. Therefore, the requirements of AS and Ind AS are aligned now.

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7 Start-up or start-up company means a private company incorporated under the 2013 Act or the Companies Act, 1956 and recognised as start-up in accordance with the notification issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry.

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Key provisions of the Schedule II

Following is an overview of the key provisions for accounting of depreciation as provided under the Schedule II:

- **Useful life and residual value of assets**: Schedule II defines depreciation as the systematic allocation of the depreciable amount of an asset over its useful life. Companies are required to depreciate assets over their useful life after considering the residual value.

  Schedule XIV to the Companies Act, 1956 (1956 Act) was prescriptive in nature as it specified the minimum rates of depreciation to be applied under Straight Line Method (SLM) or Written Down Value (WDV) method for different class of assets. Schedule II, on the other hand provides indicative useful lives for various tangible assets and states that the residual value of an asset should not be more than five per cent of the original cost of the asset.

  The guidance note clarified that the useful life and the residual value of assets are indicative in nature. Therefore, the companies may determine different useful life and residual value of the assets which could be higher or lower than those specified in the Schedule II. However, in case a company uses a different useful life (higher or lower than specified in Schedule II) or a residual value of more than five per cent, the financial statements of the company should disclose such difference and provide justification duly supported by a technical advice (external or internal).

  Moreover, both AS 10 and Ind AS 16 require that the residual value and the useful life of an asset should be reviewed at least at each FY end and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate in accordance with AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies and Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors respectively. Additionally, the Ind AS Transition Facilitation Group (ITFG) in its Bulletin 11 also clarified that the useful life and residual value of the asset should be determined using a technical advice (external or internal).

  Part B of the Schedule II explicitly states that the useful life or residual value of any specific asset as notified for accounting purposes by a regulatory authority constituted under an Act of Parliament or by the Central Government (CG) should be applied in calculating the depreciation to be provided for such asset irrespective of the requirements of the Schedule II.

  **Useful life or residual value governed by other regulatory authority**

  This provision was not present in the Schedule XIV, except for the companies engaged in the generation/supply of electricity wherein it had been specifically clarified that the depreciation charged under the Electricity Act, 2003 would prevail over the Schedule XIV for such companies.

  **Component accounting mandatory**: Useful life indicated under Schedule II is for whole of the asset. However, where cost of part of the asset is significant to total cost of the asset and useful life of that part is different from the useful life of the remaining asset, useful life of significant part should be determined separately. Such an approach is known as ‘component accounting’ which is mandatory under the 2013 Act and requires companies to identify and depreciate significant components with different useful lives separately.

  The application of component accounting could pose significant challenge for the companies in terms of identification of significant components of an asset and determining the cost of such components. The guidance note provides detailed guidance in these areas.

  **Identification of significant components**

  Identification of significant components requires a careful assessment of facts and circumstances. The guidance note gives minimum indicators to assess significant components:

  a. Threshold value to determine which asset requires componentisation
  b. Threshold value in percentage of cost of component to the total cost of the asset
  c. Proportion of useful life of that part as compared to the useful life of the asset
  d. Potential impact on the total depreciation expenditure.

  **Determination of cost of significant components**

  With respect to determination of the cost of such parts, the guidance note prescribes following criteria which can be used by the companies for determining the cost of such parts:

  a. Break-up cost provided by the vendor
  b. Cost break-up given by internal/external technical expert
  c. Fair values of various components or
  d. Current replacement cost of component of the related asset and applying the same basis on the historical cost of asset.
**Depreciation of significant components**

Schedule II requires separate depreciation only for parts of an item of tangible fixed asset that have:

a. Significant cost, and

b. Different useful lives from remaining parts of the asset.

In practice, an issue could arise in case of companies that are depreciating their Property, Plant and Equipment (PPE) based on prescribed regulatory rates. In such cases, whether such companies could identify components and depreciate them using different rates remains as a moot point.

**Amortisation of intangible assets**: Depreciation also includes amortisation of intangibles as per Schedule II. Schedule II specifically mentions that intangible assets will be amortised as per Ind AS for companies following Ind AS road map.

Accordingly, Ind AS 38, *Intangible Assets* specifies that the accounting for an intangible asset is based on its useful life. An intangible asset with a finite useful life is to be amortised, however, an intangible asset with an indefinite useful life is not amortised.

Amortisation for an intangible with finite useful life should begin when the asset is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Amortisation should cease at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with Ind AS 105, *Non-current Assets Held for Sale and Discontinued Operations* and the date that the asset is derecognised.

Additionally, the amortisation method used should reflect the pattern in which the asset’s future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, then the straight-line method should be used.

On 31 March 2014\(^\text{10}\), MCA amended the provisions relating to determination of useful lives of intangible assets prescribed in Schedule II. The amendment permitted companies to apply revenue-based amortisation, based on the proportion of actual revenue for the year as compared to the total projected revenue from the intangible asset during the concession period for ‘toll road’ intangible assets.

However, Ind AS 38 specifies that an amortisation method based on revenue generated by an activity that includes the use of an intangible asset is presumed to be inappropriate, except in very limited circumstances.

In order to transition to Ind AS, Ind AS 101, *First-time Adoption of Indian Accounting Standards* permits companies to apply a previously used amortisation method for such toll-road intangibles only to assets existing at the beginning of the first year of adoption of Ind AS.

This represented an inconsistency between the guidance in Schedule II and in Ind AS.

Accordingly, the MCA, amended\(^\text{11}\) Schedule II relating to intangible assets and clarified in the following manner:

- **Companies following Ind AS**: Companies following Ind AS would be unable to apply revenue-based amortisation method to toll road related intangible assets that are recognised after the beginning of the first year of adoption of Ind AS.

- **Companies following AS**: Companies that continue to follow AS are permitted to continue applying the exception in Schedule II and use a revenue-based amortisation method for their toll road intangibles.

**Continuous Process Plant (CPP) and multiple shift depreciation**: CPP means a plant which is required and designed to operate for 24-hours a day. The term ‘required and designed to operate for 24-hours a day’ should be interpreted with reference to the inherent technical nature of the plant i.e. the technical design of a CPP should be such that there is a requirement to run it continuously for 24-hours a day. Such a plant could be shut down for some time (for instance due to lack of demand, maintenance etc.), however, such a shut-down does not change the inherent technical nature of the plant. It would still be considered as a CPP and estimated useful life would be applicable for providing depreciation.

Additionally it is to be noted that the repetitive process plant or assembly line type plants are not CPP, as these plants do not involve significant shut-down and/or start-up costs and are not technically required and designed to operate 24-hours a day. Therefore, determination of whether a PPE is a CPP could be subjective and would require technical evaluation.

\(^{10}\) MCA notification no. G.S.R. 237(E) dated 31 March 2014.

\(^{11}\) MCA notification no. G.S.R 1075(E) dated 17 November 2016 and corrigendum dated 9 December 2016.
Schedule II indicates useful life of CPP, for example, 25 years for CPP other than those for which special rates have been prescribed in the Schedule II and certain special rates. The guidance note reiterates that the principle of estimation of useful life is also applicable to a CPP.

On the other hand, Schedule XIV, *inter alia*, specified the general rates of 15.28 per cent under WDV method and 5.33 per cent under the SLM of depreciation for ‘CPP, other than those for which special rates’ had been prescribed.

It is important to note that what has been considered as CPP under the Schedule II is the same as it was under Schedule XIV i.e. a plant which was not a CPP under Schedule XIV cannot be a CPP under Schedule II.

**Multiple shift depreciation**

The useful lives of assets specified under Schedule II are based on their single shift working. However, where a company estimated the useful life of an asset on a single shift basis at the beginning of the year but use the asset on double or triple shift during the year, then the depreciation expense would increase by 50 or 100 per cent as the case may be for that period.

The guidance note requires that the company should determine whether the use of an asset for an extra shift was on sporadic basis in the past and would continue in future also. If the use is on a sporadic basis, then the depreciation expense for the double or triple shift should be increased by 50 per cent or 100 per cent as the case may be for the period of use.

However, if the company estimates that the use of an asset for an extra shift would not be on sporadic basis i.e. the extra shift working for the asset would be on regular or continuous basis, it should reassess its useful life considering its use on extra shift basis. Hence, the reassessed useful life should then be used for the purpose of charging depreciation expense.

Schedule XIV specified substantially different requirements of depreciation. It specified separate rates of depreciation for single, double and triple shift use of assets.

Further, it should be noted that in case the useful life has been estimated on double/triple shift basis at the beginning of the year, the concept of extra shift depreciation will not apply. In such an instance, the company will need to evaluate whether there is any change in the circumstances on which the useful life of asset was based or any new developments have taken place which may have impact on the estimated useful life of the asset. If there is any such indication, the company should reassess the remaining useful life of the assets on the basis of the changed circumstances/new developments. For instance, use of the asset on a single shift basis in future.

- **Depreciation on low value items:** Schedule XIV included a specific provision for depreciating assets at the rate of 100 per cent whose actual cost did not exceed INR5,000. This provision was based on the practices followed by the companies based on the materiality of the financial impact of such charge.

However, since the useful life of an asset is a matter of estimation, therefore, Schedule II does not prescribe any such requirement. A company could have a policy to fully depreciate assets up to certain threshold limits considering materiality aspect in the year of acquisition. The materiality of such charge should be considered with reference to the cost of the asset and the size of the company.

Similar issue has been considered and clarified in the educational material on Ind AS 16 and it states that determination of an individual item as insignificant and not considering the same as PPE is a matter of professional judgement which requires careful assessment of facts and circumstances including qualitative aspects. Accordingly, individual insignificant assets below a threshold determined by the management may not be recognised as PPE. These may be expensed if their cumulative aggregate cost for that category of asset is not material.

- **Disclosures:** In case of deviation from the indicative useful life and/or residual value prescribed in Schedule II, companies are required to disclose useful life and/or residual value of assets adopted along with the fact that the adopted useful lives and residual values are duly supported by technical advice.

Keeping in view the estimations and assumptions involved around determination of useful lives/residual value, disclosure requirements prescribed under Schedule II definitely aim to promote best practices and transparency.
Revision or reopening of financial statements

The 2013 Act introduced a new requirement related to reopening or revision of accounts of the companies. There was no corresponding section in the erstwhile 1956 Act.

Sections 130 and 131 of the 2013 Act deal with the reopening or restatement of financial statements. A company would need to reopen or restate its financial statements on an order received from the competent court or Tribunal, or on application by its BoD under certain specified situations. These sections became effective from 1 June 2016.

Post the notification of sections, MCA constituted the National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) to exercise and discharge the powers and functions as conferred on it under the 2013 Act.

Background

Under the 1956 Act, the management of a company was required to prepare financial statements in relation to every FY and lay the same before the company in its AGM. The company’s financial statements once adopted in the AGM were considered as final and were generally not allowed to be reopened or restated except in few limited circumstances e.g. meeting the technical requirements of the law.

In case a material misstatement in the accounts was identified relating to PYs, whether due to occurrence of fraud or error, then these adjustments were reported as ‘prior period adjustment’ in the financial statements of the period in which such misstatements were discovered i.e. previous years’ financial statements were not restated.

However, as mentioned above, the 2013 Act allows reopening/revision of accounts after those are approved at the AGM in certain situations and provides procedural requirements in respect of revision of accounts.

Circumstances for revision of financial statements

The 2013 Act allows revision of financial statements in following cases:

- **Reopening of accounts on the court’s or Tribunal’s order:** As per Section 130 of the 2013 Act, CG, income tax authorities, SEBI or any person concerned or statutory regulatory body, can approach the Tribunal or court of competent jurisdiction and can apply for reopening the books of account in case:
  - The affairs of the company were mismanaged, casting a doubt on reliability of the financial statements.

Maximum period for reopening of accounts as per the Companies (Amendment) Act, 2017

Reopening of financial statements has been restricted up to eight FYs immediately preceding the current FY.

However, if the CG has directed to maintain books of accounts for a period longer than eight years pursuant to any investigations (as provided under Section 128(5) of the 2013 Act), then the books of account could be ordered to be re-opened within such longer period.

Additionally, the notice of reopening of accounts could be given to any other person as deemed fit by the court or the Tribunal. The representations of such person would also be considered by the court or Tribunal before passing any order. Earlier, the notice was restricted to the statutory regulatory bodies/authorities.

The accounts which are revised or re-cast would be considered as final.

- **Voluntary revision of financial statements or board’s report:** Section 131 of the 2013 Act allows the directors of the company to get the financial statements/board’s report revised in respect of any of the three preceding FYs. For revision, a company would require to obtain prior approval of the Tribunal. The Tribunal, before passing the order for revision, will give notice to the CG and income tax authorities and consider their representations, if any.

Such an application could be made only if it appears to the directors that the financial statements or board’s report of the company do not comply with the provision of Section 12912 and Section 13413 of the 2013 Act.

The 2013 Act clarifies that the revised financial statements cannot be prepared or filed more than once in any FY. Additionally, detailed reasons for revision of such financial statements or report should be disclosed in the board’s report in the relevant FY (in which such revision is being made).

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12. Section 129 requires the financial statements to give a true and fair view of the state of affairs of the companies in the form as may be provided for different class or classes in Schedule III and should comply with AS notified under Section 133 of the 2013 Act.

13. Section 134 of the 2013 Act provides for the manner of authentication of the financial statements and requires that the financial statements should be approved by the BoD. Additionally, it casts responsibility on the BoD to prepare a report containing various details which should be annexed to the financial statements to be laid before the members in the AGM.
It is pertinent to note that the company would not get an opportunity to make representation when the authorities make an application to court or Tribunal for reopening of accounts. Whereas, an application by the company for reopening of accounts or board’s report would require the government and the income tax authorities to make representation.

In case copies of financial statements or reports have been sent out to members, Section 131 specifies that the revision should be restricted to the correction of the non-compliance of the provisions of Section 129 and Section 134 of the 2013 Act, as applicable and any consequential changes.

**Procedure to be followed in case of revision/restatement of accounts**

The NCLT Rules describe the procedure relating to replacing the previous financial statements with the revised documents, provide provisions with respect to responsibility of an auditor relating to revised financial statements or report and any other directions required for revision/restatement of accounts.

**Auditor’s responsibility in case of revision of financial statements**

The 2013 Act requires that the CG should notify a provision relating to responsibility of auditors through issuance of rules. However, such rules have not been notified till date.

The Standard on Auditing (SA) 560, *Subsequent Events* requires auditors to perform additional procedures where amendments are made to the financial statements. It lays down the procedure to be followed by the auditors in two situations:

a. Facts which become known to the auditors after the date of the auditor’s report but before the date that the financial statements are issued to third parties

b. Facts which become known to the auditor after the financial statements have been issued.

**Possible implications on the company in case of revisions/reopening of accounts**

The following are the possible implications on a company when it undertakes revision/reopening of accounts:

- **Cascading impact:** The impact could be significant if the restatement is ordered of a period, many years into the past, as a restatement in one year will have a cascading effect on subsequent years*. Whereas impact for voluntary reopening is limited to preceding three years only.

- **Tax impact:** The restatement of each year need to be evaluated from provision of income tax including Minimum Alternate Tax (MAT)/income tax liabilities as a result of change in profits. The company would also need to consider filing revised income tax returns based on revised financial statements.

**Accounting requirements**

Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors* highlights the concept of retrospective restatement when financial statements contain errors. Ind AS 8 defines retrospective restatement as correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred. Therefore, the new accounting regime also reiterate the requirement of the 2013 Act as retrospective application requires amending the comparative information presented for prior periods unless it is impracticable.

As per Ind AS 8, the entity should process the retrospective application by adjusting the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented. In case it is impracticable to determine the period-specific effects for one or more prior periods presented then the entity should restate the opening balances of assets, liabilities and equity for the earliest period for which retrospective application is practicable.

On revision arising due to change in the accounting policy, restatements and reclassifications have to be disclosed with the help of a ‘third balance sheet’ with appropriate explanations as required under Ind AS 8.

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*The Companies (Amendment) Act, 2017 has restricted the reopening of financial statements up to eight FYs immediately preceding the current FY.

Uniform accounting year

As per the 2013 Act, the FY of a company should be the period ending on 31 March every year and where the company has been incorporated on or after 1 January of a year, the period ending on 31 March of the following year, in respect whereof financial statements of the company or body corporate is made up.

However, in case an application has been made by a company or body corporate, which is a holding company or a subsidiary or an associate company of a company incorporated outside India and is required to follow a different FY for consolidation of its accounts outside India, the Tribunal may if it is satisfied, allow any period as its FY, whether or not that period is a year.

Mandatory reporting on Internal Financial Controls (IFC)

The 2013 Act emphasised the importance of corporate governance with the introduction of IFC. According to it, directors of a listed company are required to state whether they had laid down IFC to be followed by the company and that such IFC are adequate and are operating effectively (Section 134(5)(e)).

However, Rule 8(5)(viii) of the Accounts Rules requires the board’s report of every company to state the details in respect of adequacy of IFC with reference to financial statements.

The Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by the ICAI in September 2015 suggested the following in respect of reporting of IFC for the given class of companies:

- **Listed companies**: The director’s responsibility statement should state that the IFC are adequate and operating effectively. The board’s report should state the adequacy of the IFC with respect to financial statements.

- **Other companies**: The board’s report should state adequacy of the IFC with respect to financial statements.

Internal audit

The 2013 Act read with the Accounts Rules requires a prescribed class of companies to appoint an internal auditor to conduct internal audit of the functions and activities of the company and would furnish a report to the BoD. An internal auditor could be an individual or a partnership firm or a body corporate. The Accounts Rules clarified that the internal auditor may or may not be an employee of the company and that non-practicing Chartered Accountants (CAs) or cost accountants could also be appointed as internal auditors.16

The Audit Committee of the company or the BoD would be required to formulate the scope, functioning, periodicity and methodology for conducting the internal audit in consultation with the internal auditor.

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15. IFC means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

Consider this

CFS
- Careful evaluation is required for identifying subsidiaries, associates and joint ventures for presenting CFS. The Companies (Amendment) Act, 2017 has amended the definition of subsidiary, associate, holding company and defined joint venture, to align them with AS/Ind AS.
- The CFS is also required to be prepared by a company which does not have a subsidiary but has an associate and/or joint venture.
- Companies should consider applicability of exemptions from preparing CFS provided under the 2013 Act.

Accounting of depreciation
- Although the provisions of Schedule II of the 2013 Act offer flexibility to the companies i.e. it allows companies to follow different useful life/residual value, the management will have to technically evaluate and make use of judgement for determination of useful life and identification of significant parts.
- Accounting of depreciation has an impact on the distributable profits and calculation of managerial remuneration.
- Useful life, depreciation method and residual values of the PPE are considered as accounting estimates.

Revision or reopening of financial statements
- The detailed requirement for revision/restatement of financial statements require involvement of current and previous auditors.
- Companies should evaluate the consequential implications of revision of financial statements on provisions such as MAT/dividend/managerial remuneration, if reported profits change on account of restatement.
- The 2013 Act now enables Ind AS to be applied in case of revision of accounts for past errors identified by management.
- The requirements of revision of accounts has been in existence in some foreign countries for a long time. Based on the experience in such countries revision of accounts is looked at critically by shareholders and other relevant stakeholders.

Mandatory reporting on IFC
- For auditors the Companies (Amendment) Act, 2017 clarifies that IFC is with respect to the financial statements while for directors the responsibility remains unchanged as required by Section 135(5)(e) i.e. both in reference to financial statements and adequacy and effectiveness of IFC in general.
Related Party Transactions (RPTs) has been an area of focus for regulators, auditors and shareholders. High volume of RPTs could reflect a poor governance framework within a company. Due to this, the 2013 Act and the Listing Regulations lay a lot of emphasis on the RPTs.

Under the 2013 Act, certain transactions with related parties, which are not in the ordinary course of business and which are not at an arm's length require the consent of the BoD of the company. Further, shareholders' approval is required for transactions where certain thresholds are met.

Additionally, Section 134 read with Section 188 of the 2013 Act also requires the details of RPTs that require consent of the BoD/ordinary resolution of members along with the justification for entering into them.

Amended definition of related party under the 2013 Act

The definition of related parties is provided in Section 2(76) of the 2013 Act, AS 18, Related Party Disclosures, Ind AS 24, Related Party Disclosures and the Listing Regulations. However, the definition in all these four documents are not aligned.
Several amendments have been made to the related party definition under Section 2(76) of the 2013 Act.

**Revised definition of a related party as per the Companies (Amendment) Act, 2017**

Related party with reference to a company means:

i. A director or his relative

ii. A Key Managerial Personnel (KMP) or his relative

iii. A firm, in which a director, manager or his relative is a partner

iv. A private company in which a director or manager or his relative\(^17\) is a member or director

v. A public company in which a director or manager is a director and holds\(^18\) along with his relatives, more than two per cent of its paid-up share capital

vi. Any body corporate whose BoD, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager

vii. Any person on whose advice, directions or instructions a director or manager is accustomed to act

Provided that nothing in sub-clauses (vi) and (vii) should apply to the advice, directions or instructions given in a professional capacity.

viii. Any body corporate which is:

a. A holding, subsidiary or an associate company of such company

b. A subsidiary of a holding company to which it is also a subsidiary or

c. An investing company or the venturer of the company\(^19\).

For private companies\(^20\) and units of an unlisted public company in an International Financial Services Centre (IFSC) in Special Economic Zones (SEZs) (specified IFSC public company)\(^21\), the above mentioned relationships (given in point (viii)) are outside the scope of RPTs.

iv. Such other person as may be prescribed.

(Emphasis added to highlight the change)

The Companies (Specification of Definitions Details) Rules, 2014 prescribe that a director (other than an Independent Director)\(^22\) or KMP of the holding company or his relative with reference to a company, should be deemed to be a related party.

**Requirements prescribed under the Listing Regulations**

As per the Listing Regulations (Regulation 2(zb)), an entity should be considered as related to the company if:

a. Such entity is a related party under Section 2(76) of the 2013 Act, or

b. Such entity is a related party under AS or Ind AS.

Companies should put in place a process to contemporaneously update the list by capturing all changes to the list of the related parties. Such changes could include new directors/relatives, acquisitions, joint ventures, investment in associates. The process to update the list would require regular notification by directors on changes in their or their relatives’ business interests.

\(^{17}\) Companies (Removal of Difficulties) Sixth Order, 2014 dated 24 July 2014 issued by the MCA.

\(^{18}\) Companies (Removal of Difficulties) Fifth Order, 2014 dated 9 July 2014 issued by the MCA.

\(^{19}\) The investing company or the venturer of a company means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate.


\(^{22}\) Companies (Specification of Definition Details) Amendment Rules, 2014 dated 17 July 2014 issued by the MCA.
The process for approvals of RPTs has been summarised in the flow chart below:

Approval process under the 2013 Act and the Listing Regulations

The 2013 Act requirements
All companies (both listed and unlisted)

All transactions - audit committee approval

Transactions under Section 188
Not in ordinary course of business/not at an arm’s length
Board’s approval required*

Other cases if certain thresholds met
Ordinary resolution at general meeting required – voting only by parties not interested in the contract/arrangement^*

Listing Regulations requirements
(Listed companies)

All transactions (even if price not charged) - prior to audit committee approval#

Transactions under Section 188
Ordinary course of business and at an arm’s length
No further approval required

Material transactions
(10 per cent of annual consolidated turnover)
Resolution at general meeting required - voting by unrelated parties whether party to a transaction or not

No material transactions
No further approval required

*No approval by way of resolution is required for transactions between the holding company and its wholly-owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

^In the case of private companies, related parties are allowed to vote.

(Source: KPMG in India’s analysis, 2018)
All RPTs require audit committee approval

Section 177 of the 2013 Act requires all RPTs to be approved by the audit committee. Earlier, this Section did not specify whether the audit committee approval needs to be a pre-approval or a post facto approval. The Companies (Amendment) Act, 2015\(^{23}\), inserted a proviso to Section 177(4)(iv) to permit an omnibus approval for RPTs proposed to be entered into by the company subject to conditions prescribed in the Rules.

The MCA notified Companies (Meetings of Board and its Powers) Second Amendment Rules, 2015\(^{24}\) and inserted Rule 6A which specifies the following conditions for an omnibus approval from an audit committee:

a. The audit committee after obtaining an approval of the BoD specify the criteria for making the omnibus approval which should include:
   i. Maximum value of the transactions, in aggregate, which could be allowed under the omnibus route in a year
   ii. The maximum value per transaction which could be allowed
   iii. Extent and manner of disclosures to be made to the audit committee at the time of seeking an omnibus approval
   iv. Review, at such intervals as the audit committee may deem fit, RPT entered into by the company pursuant to each omnibus approval made
   v. Transactions which cannot be subject to the omnibus approval by the audit committee.

b. The factors which an audit committee should consider while specifying the criteria for making an omnibus approval are as follows:
   i. Repetitiveness of the transactions (in the past or the future)
   ii. Justification for the need of an omnibus approval.

c. The audit committee should satisfy itself on the need for an omnibus approval for transactions that are repetitive in nature and that such approval is in the interest of the company.

d. The omnibus approval should contain or indicate the following:
   i. Name of the related parties
   ii. Nature and duration of the transaction
   iii. Maximum amount of transaction that can be entered into
   iv. Indicative base price or current contracted price and the formula for variation in the price, if any
   v. Any other information relevant or important for the audit committee to take a decision on the proposed transaction.

In situations where need for a RPT cannot be foreseen and aforesaid details are not available, an audit committee may request for an omnibus approval for such transactions subject to their value not exceeding INR1 crore per transaction.

e. Omnibus approval would not be valid for a period exceeding one FY and would require a fresh approval after the expiry of such FY.

f. Omnibus approval would not be made for transactions with respect to selling or disposing of an undertaking of a company.

g. Any other conditions as the audit committee may deem fit.

Key guidance provided under the Companies (Amendment) Act, 2017

Transactions not approved by the audit committee: Existing requirement for the audit committee to pre-approve all RPTs subject to the approval of the BoD or shareholders would continue. For transactions that are not covered under Section 188, the audit committee can give recommendations to the BoD, in case it does not approve the transaction.

Additionally, a transaction (involving an amount up to INR1 crore) is voidable at the option of the audit committee if it has been entered into by a director or officer of the company without its approval and has not been ratified by it within three months from the date of the transaction. These provisions (relating to audit committee approval) would not apply to a transaction (other than a transaction referred to in Section 188) between a holding company and its wholly-owned subsidiary company.

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\(^{24}\) Companies (Meetings of Board and its Powers) Second Amendment Rules, 2015 dated 14 December 2015 issued by the MCA.
Transactions under Section 188 that are not in the ordinary course of business or not at an arm’s length: Section 188 of the 2013 Act requires that the transactions with related parties that are not in the ordinary course of business and which are not at an arm’s length would require consent of the BoD of the company. Additionally, certain specified transactions would require prior shareholders’ approval by an ordinary resolution. Those transactions are as follows:

<table>
<thead>
<tr>
<th>Prescribed transaction categories</th>
<th>Amount beyond which shareholders’ approval is required</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale, purchase or supply of any goods or materials (directly or through an agent)</td>
<td>Amounting to 10 per cent or more of the turnover or INR100 crore, whichever is lower*</td>
</tr>
<tr>
<td>Selling or otherwise disposing of, or buying, property of any kind (directly or through an agent)</td>
<td>Amounting to 10 per cent or more of the net worth or INR100 crore, whichever is lower*</td>
</tr>
<tr>
<td>Leasing of property of any kind</td>
<td>Amounting to 10 per cent or more of the net worth or 10 per cent or more of the turnover or INR100 crore, whichever is lower*</td>
</tr>
<tr>
<td>Availing or rendering of any services (directly or through an agent)</td>
<td>Amounting to 10 per cent or more of the turnover or INR50 crore, whichever is lower*</td>
</tr>
<tr>
<td>Appointment to any office or place of profit in the company, subsidiary company or associate company</td>
<td>Remuneration exceeding INR2.5 lakh per month</td>
</tr>
<tr>
<td>Underwriting the subscription of any securities or derivatives of the company</td>
<td>Remuneration exceeding one per cent of the net worth</td>
</tr>
</tbody>
</table>

(*Applies to transaction or transactions to be entered into either individually or taken together with the previous transactions during a FY.)

(Source: KPMG in India’s analysis, 2018 based on the provisions of Section 188 of the 2013 Act and Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014)

The MCA through a notification clarified that transactions arising out of compromises, arrangements, and amalgamations that are dealt with under the specific provisions of the 1956 Act/2013 Act will not attract the requirements of Section 188 of the 2013 Act.

Exemption on voting by a private company: The second proviso to Section 188(1) requires a related party (who is a member) to abstain from voting on a resolution of a company to approve a contract/arrangement entered into by the company. However, this proviso is not applicable to a private company.

Additional relaxation under the Companies (Amendment) Act, 2017

A related party who is a member is allowed to vote on a resolution of a company to approve a contract/arrangement entered into by the company in which 90 per cent or more members are relatives of promoters or are related parties.

Additionally, if a contract/arrangement has been entered into by a director or any other employee, without obtaining the consent of the BoD or approval by a resolution and such a contract/arrangement has not been ratified by the BoD or by the shareholders within three months from the date on which such contract or arrangement was entered into, then such contract or arrangement should be voidable at the option of the BoD or of the shareholders.

(Emphasis added to highlight the change)

Exemption from passing a resolution: RPTs entered into between a holding company and its wholly-owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval need not require approval through passing a resolution under Section 188 of the 2013 Act.


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Requirements prescribed under the Listing Regulations

Listing Regulations pose an additional responsibility over the management of the entity as it requires them to formulate a policy on materiality of RPTs.

A transaction with a related party should be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a FY, exceeds 10 per cent of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.

All RPTs are required to be approved by an audit committee including grant of an omnibus approval on the conditions similar to Section 188 of the 2013 Act. Further, all material RPTs are required to be approved by the shareholders through an ordinary resolution. However, approval from the audit committee or shareholders is not required in the following cases:

a. Where the transactions have been entered into between two government companies (government company to have the same meaning as per Section 2(45) of the 2013 Act)

b. Where transactions are entered into between a holding company and its wholly-owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

Additionally, Regulation 23(4) of the Listing Regulations abstain all the related parties to vote on resolutions whether the entity is a related party to the particular transaction or not. This requirement exists irrespective of the fact that the transactions with the related parties may be at arm’s length and in the ordinary course of business.

Consider this

- Requirements of RPTs are now largely aligned between the 2013 Act and the Listing Regulations.

- Though there have been several amendments to the requirements relating to RPTs, it is important to note that these requirements are still onerous.

- If a company proposes certain RPTs that are expected to require approval from the members of the company, then it should plan for such approvals in advance.

- The 2013 Act requires a related party (who is a member) to abstain from voting on a resolution of a company to approve any contract or arrangement entered into by the company.

The Companies (Amendment Act), 2017 clarifies that this restriction will not be applicable to a company in which 90 per cent or more members are relatives of promoters or are related parties. This relaxation is expected to help joint venture companies and closely held companies.

- The Companies (Amendment) Act, 2017 clarifies that the existing requirement for the audit committee to pre-approve all RPTs subject to the approval of the BoD or shareholders as required by Section 188 would continue. For transactions that are not covered under Section 188, the audit committee could give recommendations to the BoD, in case it does not approve the transaction.

Further, RPTs between a holding company and its wholly-owned subsidiary that do not require board’s approval under Section 188, would not require approval of the audit committee.

- A transaction (involving an amount up to INR1 crore) is voidable at the option of the audit committee if it has been entered without its approval and has not been ratified subsequently by it as per the Companies (Amendment) Act, 2017.
Corporate Social Responsibility (CSR)

The government introduced mandatory CSR requirements in the 2013 Act. The 2013 Act mandates companies to spend on social and environmental welfare, making India perhaps one of the very few countries in the world to have such a law and requirement. The CSR provision became effective from 1 April 2014. Significant amendments have been made to the CSR provisions through issuance of various notifications and clarifications (including FAQs) to streamline the implementation of the CSR provisions by companies. In the past, ICAI has also issued a Guidance Note on accounting for expenditure on CSR (GN on CSR) to provide guidance on accounting as well as suggesting best practice for disclosure and presentation of CSR expenses in the financial statements. We have highlighted the guidance given in the GN on CSR in this chapter.
Applicability

The 2013 Act mandates that every company (including its holding or subsidiary, as well as foreign companies with project office/branch in India) to undertake CSR activities if they meet certain thresholds.

Revised criteria for CSR eligibility under the Companies (Amendment) Act, 2017

A company would fall within the ambit of CSR provisions if any of the following thresholds are met:

- Net worth of INR500 crore or more
- Turnover of INR1,000 crore or more
- Net profit of INR5 crore or more during the immediately preceding FY.

(Emphasis added to highlight the change)

If a company meets any of the above threshold then it is required to spend two per cent of its average net profits (made during three immediately preceding FYs) as a CSR spend.

Explanation for net profits under the Companies (Amendment) Act, 2017

Net profit should not include such sums as may be prescribed, and should be calculated in accordance with the provisions of Section 198 of the 2013 Act. The Companies (Amendment) Act, 2017 has made changes to Section 198 with regard to computation of net profits. Refer to ‘calculation of net profit to compute CSR spend’ for details on this topic.

While working with the requirements of CSR applicability, companies faced various issues. Few of those issues are as follows:

- **Applicability to holding or subsidiary companies:**
  One question raised was whether a holding or a subsidiary of a company (which fulfils the criteria for CSR applicability under the 2013 Act) also has to comply with the CSR provisions, even if such holding or subsidiary itself does not fulfil those criteria. The FAQs issued by the MCA clarify that a holding or a subsidiary of a company is not required to comply with the CSR provisions unless the holding or subsidiary itself fulfils the CSR criteria.

- **Applicability to Section 8 companies under the 2013 Act:**
  The FAQs issued by the MCA clarify that CSR provisions of the 2013 Act apply to ‘every company’ and no specific exemption is given to Section 8 companies. Hence, Section 8 companies are required to follow CSR provisions.

Every company that ceases to be covered under the CSR provisions would not be required to constitute a CSR committee and would not be required to comply with the CSR provisions (Section 135(2)-(5) of the 2013 Act).

Calculation of net profit to compute CSR spend

As per the Companies (CSR Policy) Rules, 2014 (CSR Rules), net profit means the net profit of a company as per its financial statements prepared in accordance with the applicable provisions of the 2013 Act, but would not include the following:

- Any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise
- Any dividend received from other companies in India, which are covered under and complying under Section 135 of the 2013 Act.

Accordingly, for a CSR contribution to be made in 2017-18, average of the net profits for the immediately preceding three FYs i.e. 2014-15, 2015-16 and 2016-17 would be computed.
Section 198 of the 2013 Act specifies additions/deletions to be made while calculating the net profit of a company (mainly it excludes capital payments/receipts, income tax, set-off of past losses). Additionally, the computation of net profit for CSR spend calculation would be based on profit before tax.

In respect of a foreign company, the CSR committee would comprise at least two persons of which one person should be as per the Section 380(1)(d) of the 2013 Act (i.e., person authorised to accept service of process and any notices or other documents on behalf of the foreign company) and another person should be nominated by the foreign company.

The CSR Rules provide that net profit in respect of a FY for which the relevant financial statements were prepared in accordance with the provisions of the 1956 Act would not be required to be re-calculated in accordance with the 2013 Act. Also in case of a foreign company, net profit would mean net profit of such company as per the statement of profit and loss prepared in terms of Section 381(1)(a) read with Section 198 of the 2013 Act.

CSR committee

Every company required to make a CSR spend should constitute a CSR committee. The CSR committee would comprise three or more directors, out of which at least one director should be an Independent Director.

However, an unlisted public company/private company which is not required to appoint an Independent Director, would constitute a CSR committee without an Independent Director (as per the CSR Rules (Rule 5(1)).

A private company with only two directors on its BoD would constitute its CSR committee with those two directors.

The BoD of the company are required to approve CSR policy after considering the recommendations made by the CSR committee and should also ensure that the activities included in the CSR policy are undertaken by the company.

Eligible activities for CSR spend

Schedule VII to the 2013 Act lays down a list of activities which are eligible for the CSR expenditure and could be included by companies in their CSR policies. Following are the key headline activities specified in the Schedule VII of the 2013 Act:

a. Eradication of hunger, poverty and malnutrition, promotion of health care including preventive health care and sanitation including contribution to the Swach Bharat Kosh set-up by the CG for the promotion of sanitation and making available safe drinking water

b. Promotion of education including special education and employment enhancing vocation skills

c. Promotion of gender equality and empowerment of women, setting up homes and hostels for women and orphans, setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups

Additional adjustments to be made while computing net profits as per the Companies (Amendment) Act, 2017

While calculating net profits of the company, any amount representing unrealised gains, notional gains or revaluation of assets have to be excluded from net profits.

However, any amount representing profits by way of premium on shares or debentures of the company, which are issued or sold by an investment company should not be excluded from the net profits as per the Companies (Amendment) Act, 2017.

Responsibilities of the CSR committee as per the Companies (Amendment) Act, 2017

The CSR committee would be responsible for the following activities:

a. Formulation and recommendation to the BoD, a CSR policy indicating the activities to be undertaken by the company in areas or subject, specified in Schedule VII to the 2013 Act

b. Recommendation of the amount of expenditure to be incurred on the activities referred to in clause (a) above and

c. Monitoring the CSR policy of the company from time to time.

Requirement under the Companies (Amendment) Act, 2017

A company which is not required to appoint an Independent Director under Section 149(4) of the 2013 Act, should have two or more directors in its CSR committee.
d. Environmental sustainability

e. Protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art

f. Measures for the benefit of armed forces veterans, war widows and their dependents

g. Training to promote rural sports, nationally recognised sports, paralympic sports and olympic sports

h. Contribution to the Prime Minister’s National Relief Fund or any other fund set up by the CG or the state governments for socio-economic development and relief and funds for the welfare of the scheduled castes, the scheduled tribes, other backward classes, minorities and women

i. Contributions or funds provided to technology incubators located within academic institutions which are approved by the CG

j. Rural development projects

k. Slum area development.

Companies should give preference to the local area and areas around it where it operates, for spending the amount earmarked for CSR activities.

The MCA has also clarified that the CSR activities enumerated in the Schedule VII to the 2013 Act are broad-based and are intended to cover a wide range of activities. Thus, these prescribed activities should be interpreted liberally to capture their essence.

Different forms for undertaking CSR activities

A company can undertake CSR activities in the following ways:

a. **CSR activities itself:** A company could undertake the CSR activities itself as per its stated CSR policy either in new projects or ongoing projects.

b. **CSR activities through a company/trusts/society established under Section 8 of the 2013 Act:**

   i. **Companies established by the company or with any other company:** A company established under Section 8 of the 2013 Act, a registered trust, or a registered society established by the company along with any other company

   ii. **Companies established by the central or state government:** Section 8 company, a registered trust, or a registered society established by the central or state government or any entity established under an Act of Parliament or a state legislature

iii. **Companies established by others:** Any other Section 8 company, registered trust, or a registered society.

If a company decides to undertake CSR activities through a company established Section 8 of the 2013 Act, a registered trust or a registered society (which are neither established by it or central/state government) then such Section 8 company, trust or registered society should have an established track record of three years in undertaking similar programmes or projects.

Additionally, the company under the obligation of CSR provisions would have to specify the projects and programmes to be undertaken by such Section 8 company, trust or registered society, including modalities of utilisation of funds of such projects and programmes and the monitoring and reporting mechanism.

c. **CSR in collaboration with other companies:** A company could collaborate with other companies for undertaking projects/programmes or CSR activities in such a manner that CSR committees of respective companies are in a position to report separately on such projects/programmes.

d. **Building CSR capacities of personnel and implementing agencies:** Companies could build CSR capacities of their own personnel as well as those of their implementing agencies through institutions with established track records of at least three FYs. However, such expenditure including expenditure on administrative overheads should not exceed five per cent of the total CSR expenditure of the company in one FY.

e. **Contribution to funds specified in the Schedule VII:** Companies could also contribute in the funds specified in Schedule VII of the 2013 Act, for example:

   - Swach bharat kosh set-up by the CG for the promotion of sanitation and making available safe drinking water
   - Prime minister’s national relief fund or any other fund set up by the CG or the state governments for socio-economic development and relief and funds for the welfare of the scheduled castes, the scheduled tribes, other backward classes, minorities and women
   - Contribution or fund provided to technology incubators located within academic institutions which are approved by the CG.

29. FAQs with regard to CSR dated 12 January 2016 issued by the MCA.

30. MCA notification no. GSR 540(E) dated 23 May 2016.
Ineligible activities for CSR spend

Following activities are not eligible for the CSR spend:

a. Normal course of business activities
b. Direct/indirect contribution to any political party
c. Only for the benefit of the employees and their families
d. One-off events
e. Regulatory expenses
f. Activities undertaken outside India.

Treatment of CSR expenditure in the financial statements

The amount of contribution made towards CSR would generally, be treated as an expense and charged to the statement of profit and loss, unless it gives rise to an asset. According to the GN on CSR, an asset would be recognised on the basis of an evaluation of control over the asset and accrual of future economic benefits to the company. Based on GN on CSR, it seems that a company would be unlikely to demonstrate either the control or future economic benefits criteria for the CSR assets.

In case a company spends more than the amount specified in Section 135(1) of the 2013 Act (i.e. more than 2 per cent of its average net profits of three preceding years) on CSR, the excess amount spent cannot be carried forward to the subsequent years and adjusted against the next year’s CSR expenditure.

However, the company’s BoD may carry forward any unspent amount out of the minimum required CSR expenditure to the next FY. However, the carried forward amount would be over and above the next year’s CSR allocation equivalent to at least 2 per cent of the average net profit of the company of the immediately preceding three years.

It is important to note that under Ind AS, Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, requires recognition of a provision when all the following conditions are being met:

a. An entity has a present obligation (legal or constructive) as a result of a past event
b. It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and
c. A reliable estimate could be made of the amount of obligation.

Based on the requirements of Ind AS 37 and the 2013 Act, ITFG in its clarifications bulletin 8 clarified that the provision for any shortfall in the amount that was expected to be spent on the CSR activities as per the 2013 Act and the amount actually spent at the end of a reporting period, may not be required in the Ind AS financial statements. However, if a company has already undertaken certain CSR activity for which an obligation has been created, for example, by entering into a contractual obligation, or either a constructive obligation has arisen during the year, then in accordance with Ind AS 37, a provision for the amount of such CSR obligation, should be recognised in the Ind AS financial statements.

Key tax benefits of CSR expenditure

As per the Finance Act 2014, expenditure on CSR does not form part of the business expenditure. However, spending on certain activities such as Prime Minister’s National Relief Fund, scientific research, rural development projects, skill development projects, agricultural extension projects, etc. (part of the Schedule VII to the 2013 Act) would be eligible for exemptions under the Income Tax Act, 1961 (IT Act).

Disclosures

A company within the ambit of CSR provisions has to provide following disclosures:

- **Financial statements**: Disclose the amount of expenditure incurred on CSR by way of a note to the statement of profit and loss.

  The GN on CSR require expenditures on CSR activities to be presented as a separate line item under the term ‘CSR expenditure’ in the statement of profit and loss. Additionally, a note containing the break-up of various heads of expenses relating to the item CSR expenditure should be provided.

  If a company has made a provision for unspent CSR amount then it should be presented as per the requirements of the Schedule III to the 2013 Act. The movements in the provision during the year should also be shown separately.

  Additionally, a company should also disclose RPTs e.g. contribution to a trust controlled by the company in relation to CSR expenditure.

- **Cash flow statement**: Disclose in the notes to cash flow statement the expenditure incurred on CSR provisions.

- **BoD’s report**: It should include the details about the policy developed and implemented by the company on CSR initiatives along with the annual report on CSR undertaken during the year. A company is required to display these reports on the company’s website, if any.

  A foreign company should also contain an annexure regarding the report on CSR in its balance sheet (filed under Section 381(1)(b) of the 2013 Act).
Revised disclosure norms under the Companies (Amendment) Act, 2017

If the CSR policy is being made available on the company’s website, then the company could provide the salient features of the CSR policy and any change therein briefly in the BoD’s report and should indicate the web address at which the complete policy is available.

Requirements prescribed under the Listing Regulations

Regulation 34(2)(f) of the Listing Regulations requires mandatory submission of Business Responsibility Report (BRR) for top 500 listed companies based on market capitalisation (calculated as on 31 March of every year) along with the annual report.

The BRR should describe the initiatives taken by the said listed entities from an environmental, social and governance perspective, in the format as specified by SEBI from time to time.

Additionally, the listed entities other than the top 500 listed entities and listed entities which have listed their specified securities on the SME exchange, could include these BRRs on a voluntary basis in the specified format.

Consider this

- Companies should formulate the CSR policy and effectively monitor the compliance with the CSR requirements.
- The CSR activities mentioned in Schedule VII of the 2013 Act are broad-based and intended to cover wide range of activities. Many more can be covered by the companies.
  
  Additionally, the Companies (Amendment) Act, 2017 provides discretion to the companies to spend the CSR amount in the areas other than their local area of business or industry.
- The CSR expenditure does not specifically qualifies for exemptions under the Income Tax Act, 1961. However, certain activities forming part of Schedule VII of the 2013 Act are covered under tax exemptions.
- Reasons for not spending the amount set aside for CSR in a FY also need to be disclosed in the BoD’s report.
- Companies conducting CSR through a Section 8 company, trust or society (established by it) should carefully evaluate if such a company, trust or society would be consolidated in its CFS.
Companies can cater to their financial needs in various forms, such as raising capital through issuance of shares/debentures, acquiring funds from lending institutions, etc. An alternate mode through which companies can fulfil their financial needs is through acceptance of deposits from its members or public.

In order to ensure better transparency and security of the depositors, the 2013 Act prescribes stringent provisions to be complied with by companies while accepting deposits.

Applicability of the 2013 Act on companies

The deposit related provisions are applicable to the following classes of companies:

- A company that accepts deposits from its members. Such a company has to pass a resolution in its general meeting according to the Rules prescribed and subject to the fulfilment of the specified conditions (Section 73(2)) (discussed under the head ‘Conditions for acceptance of deposits’)

- A company that is eligible to accept deposits from the public (Section 76) (i.e. eligible company as defined under the Companies (Acceptance of Deposits) Rules, 2014 (Deposits Rules)).

32. An eligible company means a public company fulfilling the following conditions:
   a. Net worth of not less than INR100 crore or a turnover of not less than INR500 crore
   b. Obtained prior consent of the company in the general meeting by means of a special resolution*, and
   c. Filed the said resolution with the ROC before making any invitation to the public for acceptance of deposits.

(*In case, deposit is with respect to the limits specified under Section 180(1)(c) of the 2013 Act, an ordinary resolution may suffice the requirement.)
However, certain companies are exempted from the deposit related provisions and they are as follows:

- A banking company
- An Non-Banking Financial Company (NBFC)
- A housing finance company
- A company as may be specified by the CG after consultation with the Reserve Bank of India (RBI).

**Definition of the term ‘deposits’**

The 2013 Act defines the term ‘deposits’. It includes any receipt of money by way of deposit or loan or in any other form by a company, but does not include such categories of amount as may be prescribed in consultation with RBI.

Further, the Deposits Rules provide various categories and items that are excluded from the definition of deposits. Some of the significant items which are not to be categorised as deposits are as follows:

- **Receipt of amount towards subscription of securities in certain situations:** An amount received towards subscription of securities would not be treated as a deposit except in following situations:
  - The securities against which amount has been received could not be allotted within 60 days from the date of receipt of the application money, or
  - Advance for such securities and such application money or advance has not been refunded to the subscribers within 15 days from the date of completion of 60 days.

- **Receipt of amount from directors:** Any amount received from a person who, at the time of the receipt of the amount, was a director of the company or a relative of the director of the private company.

  However, such a director or a relative of a director (in case of private company) is required to furnish a declaration in writing to the effect that such an amount has not been given out of funds acquired by him through borrowing or accepting loans or deposits from others. Additionally, the company should disclose the details of money so accepted in its board’s report.

- **Receipt of amount from an employee:** An amount received from an employee of the company would not be considered as a deposit if it does not exceed his/her annual salary under a contract of employment, and should be in the nature of non-interest bearing security deposit.

- **Receipt of amount for the purpose of business:** Any amount received in the course of, or for the purposes of, the business of the company. For example, amount received as:
  a. An advance for the supply of goods or provision of services provided that such an advance is appropriated against supply of goods or provision of services within a period of 365 days from the date of acceptance of such advance
  b. An advance received in connection with consideration for an immovable property under an agreement/arrangement, provided that such advance is adjusted against such property in accordance with the terms of the agreement/arrangement
  c. An advance received under long-term projects for supply of capital goods except those covered under (b) above
  d. An advance towards consideration for providing future services in the form of a warranty or maintenance contract as per the written agreement/arrangement, if the period for providing such services does not exceed the period prevalent as per common business practice, or five years from the date of acceptance of such service, whichever is less.

  The above amounts would be deemed to be deposits on the expiry of 15 days from the date they become due for refund.

  Further, if the amount (given in point (a), (b) and (c) above) become refundable (with or without interest) due to the reasons that the company accepting the money does not have necessary permission or approval, wherever required, to deal in the goods or properties or services for which the money was taken, then the amount received would be deemed to be a deposit.

- **Debentures**
  - **Secured:** Secured debentures (including optionally convertible, compulsorily convertible and non-convertible) are not to be considered as deposits.
  - **Unsecured:**
    - Compulsorily convertible debentures: If compulsorily convertible debentures are issued to a company, then these are not to be classified as deposits.
    - **Resident:**
      - Similarly, if these debentures are issued to a resident, these are not to be considered as deposits if debentures are convertible within 10 years.

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33. FAQs on the 2013 Act issued by the Corporate Laws & Corporate Governance Committee of the ICAI.
- Optionally convertible debentures and non-convertible debentures: If optionally convertible debentures and non-convertible debentures are issued to a company or a foreign body, then these are not to be classified as deposits.

However, if such debentures are issued to a resident, then these will be considered as deposits unless the debentures are listed on the stock exchange.

- Receipt of amount from another company: Any amount received by a company from any other company would be excluded from the definition of deposit.

Conditions for acceptance of deposits

Every company (including eligible company) intending to invite deposits is required to comply with the following conditions while accepting deposits:

- Issue of a circular
  - Company covered under Section 73(2): The company would need to issue a circular to all its members which includes the following:
    a. A statement showing the financial position of the company
    b. Credit rating obtained
    c. Total number of depositors
    d. Amount due towards deposits in respect of any previous deposits accepted by the company
    e. Other particulars in such form and in such manner as may be prescribed.
  - Eligible company: An eligible company should issue a circular in the form of an advertisement in Form DPT-1.
    A copy of the circular should be placed on the company’s website.

- Filing of circular with the ROC: A copy of the circular (including statement as referred above) should be filed with the ROC within 30 days before the date of issue of the circular.

- Maintenance of liquid assets (Revised threshold as per the Companies (Amendment) Act, 2017): On or before 30 April of each year, an amount not less than 20 per cent of the amount of deposits maturing during the following FY should be kept in a scheduled bank (in a separate bank account) to be called as ‘deposit repayment reserve account.’ Such a reserve should be used only for the purpose of repayment of deposits. (Emphasis added to highlight the change)

- Creation of a security: Security by way of a charge on assets (as referred to in Schedule III to the 2013 Act) excluding intangible assets should be created by every company for due repayment of the amount of deposit and interest thereon for an amount which should not be less than the amount remaining unsecured by the deposit insurance. Such a security should be created on specific movable or specific immovable property of the company.

In case of deposits secured by a charge on assets, the amount of such deposits and the interest payable thereon should not exceed the market value of such assets as assessed by a registered valuer.

Additionally, a company is required to appoint one or more trustees to create security for the deposits. A deposit trust deed in Form DPT-2 should be executed at least seven days before issuing the circular/advertisement.

Deposits which are not secured, or are partially secured, should be termed as ‘unsecured deposits’ and should be quoted in every circular, advertisement or in any document related to invitation or acceptance of deposits.

- Credit rating
  - Eligible company: Every eligible company is required to obtain at least once in a year, a credit rating for deposits accepted by it and the copy of such rating should be sent to the ROC along with the return of deposits in Form DPT-3.
    Such a credit rating should not be below the minimum investment grade rating or other specified rating for fixed deposit from any one of the approved credit rating agencies (as specified for NBFCs).
  - Company covered under Section 73(2): Company taking deposits from its members also needs to provide credit rating obtained in the circular issued to its members as explained above.
• Repayment of deposits: A company should not default in the repayment of the deposit (or interest thereon) accepted before or after the commencement of the 2013 Act.
  
  – Deposits accepted before the commencement of the 2013 Act: In case a company has accepted deposits before the commencement of the 2013 Act and the amount of such deposit or part thereof or any interest due thereon remains unpaid on such commencement or becomes due at any time thereafter, then the company should comply with the following requirements:
    a. File a statement of all the deposits accepted and sums remaining unpaid on such amount with the interest payable thereon along with the arrangements made for such repayment with ROC within three months from the commencement of the 2013 Act or the due date of such payments.
  
  The Tribunal can extend the timelines for repayment of deposits on an application made to it after considering the relevant factors.

  – Exemptions: As per a clarification issued by MCA, the amount received by private companies from their members, directors or their relatives prior to 1 April 2014, should not be treated as deposits under the 2013 Act and the related Rules, provided disclosure of such amounts has been given in the notes to the financial statements for FY commencing on or after 1 April 2014.34

Similarly, in case a company had accepted public deposits under the relevant provisions of the 1956 Act and the related Rules and has been repaying such deposits and interest in accordance with such provisions, the company is not required to repay such deposits within a year. However, it would need to comply with the other requirements of the 2013 Act and continue to repay such deposits and interest on due dates for the remaining period of such deposits.

Revised timeline for repayment as per the Companies (Amendment) Act, 2017

Deposits accepted by the company before the commencement of the 2013 Act should be repaid within three years from the date of commencement of the 2013 Act or on or before expiry of the period for which the deposits were accepted, whichever is earlier.

However, renewal of any such deposits should be done in accordance with the provisions of acceptance of deposits under the 2013 Act (i.e. Chapter V of the 2013 Act) and the related Rules.

(Emphasis added to highlight the change)

Relaxation under the Companies (Amendment) Act, 2017

Companies which have made good on a default committed in the past have been allowed to accept deposits after five years from the date of the default remediation.

Other relevant provisions

• Form of application for deposits: A depositor35 is required to provide a declaration that the deposit has not been made out of any money borrowed from any other person in a form of application specified by the company.

• Appointment of a nominee: A depositor may, at any time, nominate any person to whom his deposits should vest in the event of his death.

• Deposit receipts: Every company is required to furnish to the depositor a receipt for the amount of money received within 21 days from the date of receipt of money/realisation of cheque/date of renewal.

Permissible amount of deposits

The 2013 Act along with the Deposits Rules, prescribes the following limits for acceptance of deposits from members and the public:

• Eligible company (excluding government company): An eligible company is allowed to accept deposits of up to 10 per cent of the aggregate of its paid-up share capital, free reserves and securities premium account from its members.

In case of any other deposits, deposits of up to 35 per cent of the aggregate of the paid-up share capital, free reserves and securities premium account are permitted.

34. MCA general circular no. 05/2015 dated 30 March 2015.

35. As per the Deposits Rules, depositor means:
   a. Any member of the company who has made a deposit with the company in accordance with the provisions under Section 73(2) of the 2013 Act or
   b. Any person who has made a deposit with a public company in accordance with the provisions under Section 76 of the 2013 Act.
• **Other company (i.e. public company which is not an eligible company and private company):** Such other company is allowed to accept deposits of up to 35 per cent of its paid-up share capital, free reserves and securities premium account from its members.

• **Private company:** A private company is allowed to accept deposits of up to 100 per cent of the aggregate of its paid-up share capital, free reserves and securities premium account from its members and does not have to comply with the conditions specified under Section 73(2) of the 2013 Act. It has to file details of monies so accepted with ROC in a specified manner.

The above mentioned maximum limit (i.e. up to 100 per cent of the aggregate of its paid-up share capital, free reserves and securities premium account) would not be applicable to a private company which fulfills any of the following criteria:

a. It is a start-up company for five years from the date of its incorporation

b. It fulfils all the following conditions:
   i. It is not an associate or a subsidiary company of any other company
   ii. Borrowings of such a company from banks or financial institutions or any body corporate is less than twice of its paid-up share capital or INR50 crore, whichever is less and
   iii. It has not defaulted in the repayment of such borrowings subsisting at the time of accepting deposits under Section 73.

However, these companies would still be required to file the details of monies so accepted to the ROC in Form DPT-3.

**Interest payable on deposits**

The 2013 Act along with the Deposits Rules, provides that the rate of interest on deposits should not exceed the maximum rate of interest prescribed by RBI for acceptance of deposits by NBFCs.

**Tenure of deposits**

Deposits should not be repayable within a period of less than six months or more than 36 months from the date of acceptance or renewal as per the Deposits Rules.

However, to be able to meet its short-term funds requirements, a company is permitted to accept deposits for a period earlier than six months (but not earlier than three months), provided such deposits should not exceed 10 per cent of the aggregate of the paid-up share capital, free reserves and securities premium account of the company.

**Premature repayment of deposits**

If a company repays deposits before its maturity date, on the request of the depositor, then the rate of interest payable would be reduced by 1 per cent from the rate at which the company would have paid the deposit on the due date. However, rate of interest on premature repayment would not be reduced when the repayment is made for providing war risk, or other related benefits to personnel of the armed forces or to their families, on an application made by the associations or societies formed by such personnel, during the period of emergency declared under Article 352 of the Indian Constitution.

**Penal provisions**

In case of deposits (secured or unsecured) matured but that remain unpaid, a company is required to pay a penalty of 18 per cent per annum for the overdue period.

Additionally, the 2013 Act along with the Deposits Rules impose stringent penal provisions in case it is proved that the deposits have been accepted by the company (including its officers) knowingly or willfully with the intent to defraud the depositors or for any fraudulent purpose.

**Disclosures**

Following disclosures are required:

• **Return of deposits:** Every company is required to file with the ROC a return of deposits (comprising information contained therein as on 31 March of that year duly audited by the auditor of the company) in Form DPT-3, on or before 30 June of every year along with the specified fees.

• **Financial statements:** Every company is required to disclose the amount received from the director (also relatives of directors in case of a private company) in the notes to the financial statements.

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36. Companies (Acceptance of Deposits) Second Amendment Rules, 2017 dated 19 September 2017 issued by the MCA.
Consider this

- Deposits Rules specify items or categories which are specifically excluded from the term ‘deposits’. However, certain companies that may have received a consideration for more than 365 days for providing services would need to consider the requirements of the deposits rules.
- Deposits should not be repayable within a period of less than six months or more than 36 months from the date of acceptance or renewal.
- The rate of interest on deposits should not exceed the maximum rate of interest prescribed by RBI for acceptance of deposits by NBFCs.
- The 2013 Act contained a requirement that companies accepting deposits should invest in deposit insurance contract. The Companies (Amendment) Act, 2017 has omitted this requirement.
- Companies were required to deposit an amount equal to 15 per cent of the amount of deposits maturing during a FY and the following FY in a deposit repayment reserve account up to 30 April of each year.

The Companies (Amendment) Act, 2017 changes the above requirement and now a company would need to maintain a deposit repayment reserve account in a scheduled bank up to 20 per cent of the amount of deposits maturing during the following FY.
- Stringent penal provisions are imposed in case deposits are received with the intent to defraud the depositors or for any fraudulent purpose.
Role and responsibilities of directors

The directors of a company are responsible for achieving the objects of a company, decide the strategy and policies of the company and are accountable to various stakeholders of a company. Therefore, the directors should understand their role and responsibilities towards the company and other stakeholders.

The 2013 Act and the Listing Regulations took note of this fact and accordingly prescribed stringent guidelines with respect to the appointment, role and responsibilities of the directors.

Minimum and maximum number of directors

Depending upon the class of a company, following are the minimum number of directors required under the 2013 Act:

a. A public company - Three directors
b. A private company - Two directors
c. One person company - One director.

The maximum number of directors would be 15. However, the number of directors can be increased after passing a special resolution. Additionally, certain prescribed class of companies should appoint at least one woman director on their board (discussed under ‘classification of directors’).

The provisions relating to maximum limit of directors (15) and increase in the limit by special resolution would not be applicable to Section 8 companies.

37. MCA notification no. G.S.R. 584(E) dated 13 June 2017.
### Classification of directors

A company should have following class of directors depending upon the prescribed requirements:

<table>
<thead>
<tr>
<th>Classification</th>
<th>Particulars</th>
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<tbody>
<tr>
<td>Resident director</td>
<td><strong>Revised criteria for a resident director under the Companies (Amendment) Act, 2017</strong>&lt;br&gt; All companies should have at least one director whose stay in India has not been less than 182 days during the FY. &lt;br&gt; <strong>However, in case of a newly incorporated company this requirement would apply proportionately at the end of the FY in which it has been incorporated.</strong> (Emphasis added to highlight the change)</td>
</tr>
<tr>
<td>Woman director</td>
<td>A listed company and an unlisted public company is required to appoint at least one woman director if it has either:&lt;br&gt; - Paid-up share capital of INR100 crore or more, or&lt;br&gt; - Turnover of INR300 crore or more.</td>
</tr>
<tr>
<td>Independent Director</td>
<td><strong>Public companies</strong> are required to appoint at least two Independent Directors if they meet any of the following criteria:&lt;br&gt; - Paid-up share capital of INR10 crore or more&lt;br&gt; - Turnover of INR100 crore or more, or&lt;br&gt; - Outstanding loans/debentures/deposits exceeding INR50 crore.&lt;br&gt;The following class of unlisted public companies are not required to appoint Independent Directors:&lt;br&gt; a. A joint venture&lt;br&gt; b. A wholly-owned subsidiary and&lt;br&gt; c. A dormant company.&lt;br&gt;<strong>Listed public company</strong> should have at least one-third of the total number of directors as Independent Directors.</td>
</tr>
<tr>
<td>Director elected by</td>
<td>Listed company should have one small shareholders’ director subject to receipt of a notice by either:&lt;br&gt; - 1,000 small shareholders, or&lt;br&gt; - One-tenth of the total number of such shareholders.</td>
</tr>
<tr>
<td>small shareholders</td>
<td>Articles of a company may authorise appointment of an additional director (other than a person who fails to get appointed as a director in a general meeting) at any time.</td>
</tr>
<tr>
<td>Additional director</td>
<td><strong>Revised requirements of the Companies (Amendment) Act, 2017</strong>&lt;br&gt;An alternate director can be appointed (not being a person holding any alternate directorship for any other director in the company or holding directorship in the same company) in place of a director who is not present in India for a period of not less than three months subject to the following conditions:&lt;br&gt; - Company is authorised by its articles to make the appointment&lt;br&gt; - Appointment to take place by passing an ordinary resolution.&lt;br&gt;A director appointed in place of an Independent Director should possess requisite qualifications to be appointed as an Independent Director. (Emphasis added to highlight the change)</td>
</tr>
</tbody>
</table>

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38. The paid-up share capital or turnover or outstanding loans/debentures/deposits existing on the last date of latest audited financial statements should be taken into account.  
39. In case a company fails to meet any of the above given thresholds relating to appointment of an Independent Director for a consecutive period of three years, then such a company is not required to appoint Independent Directors till such time it meets either of the conditions.
<table>
<thead>
<tr>
<th>Classification</th>
<th>Particulars</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nominee director</td>
<td>BoD authorised by articles of a company can appoint any person as a director nominated by any institution in accordance with the provisions of the prevalent law or any agreement or by the central or the state government by virtue of its shareholding in a government company.</td>
</tr>
<tr>
<td>Managing director (MD)</td>
<td>A director who by the virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its BoD, is entrusted with substantial powers of management of the affairs of the company. The term MD would include a director occupying the position of MD, by whatever name called.</td>
</tr>
<tr>
<td>Whole-Time Director (WTD)</td>
<td>A director who is in the whole-time employment of the company.</td>
</tr>
<tr>
<td>Manager</td>
<td>An individual who, subject to the superintendence, control and direction of the BoD, has the management of the whole, or substantially the whole, of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called, whether under a contract of service or not.</td>
</tr>
</tbody>
</table>

(Source: KPMG in India’s analysis, 2018)

Additionally, every listed company and every unlisted public company with a paid-up share capital of INR10 crore is required to appoint a whole-time KMP40.

**Requirements prescribed under the Listing Regulations**

- **Number of directors**: The BoD of a listed entity should have an optimum combination of executive and non-executive directors with at least one woman director. However, at least 50 per cent of the BoD should comprise of non-executive directors. Following conditions should also be taken care of:
  - **In case a chairperson of the BoD is a non-executive director**: At least one-third of the BoD should comprise of Independent Directors.
  - **In case of a regular non-executive chairperson also a promoter or related to any managerial personnel of the entity**: At least half of the BoD should comprise of Independent Directors.
  - **In case there is no regular non-executive chairperson**: At least half of the BoD should comprise of Independent Directors.
  - **In case of a material subsidiary**: At least one Independent Director on the BoD of the listed entity should be a director on the board of an unlisted material subsidiary, incorporated in India.

**Number of directorships**

A person is not permitted to hold office as a director including alternate directorship, in more than 20 companies at the same time and of which the maximum number of public companies in which a person can be appointed as a director could be up to 10.

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40. KMP in relation to a company, means:
   a. Chief Executive Officer or the managing director or the manager
   b. The company secretary
   c. The whole-time director
   d. The Chief Financial Officer,
   e. Such other officer, not more than one level below the directors who is in whole-time employment, designated as KMP by the BoD and
   f. Such other officer as may be prescribed.

41. Material subsidiary is a subsidiary, whose income or net worth exceeds 20 per cent of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year.

42. For reckoning the limit of public companies in which a person can be appointed as a director, directorship in private companies that are either holding or subsidiary company of a public company should be included.
Dormant companies to be excluded from the threshold as per the Companies (Amendment) Act, 2017

Directorship in a dormant company is to be excluded while determining the threshold of 20 companies.

Requirements prescribed under the Listing Regulations

The Listing Regulations additionally provide that a person is not allowed to serve as an Independent Director in more than seven listed entities.

However, in case the person is serving as a WTD in any listed entity, he/she could be an Independent Director in only three listed entities. (Regulation 25(1))

Independent Directors - norms related to appointment, role and responsibilities

Revised definition of an Independent Director as per the Companies (Amendment) Act, 2017

An Independent Director is a director other than a MD, a WTD or a nominee director who, inter alia, in the opinion of the board, is a person of integrity and possesses relevant expertise and experience and does not have pecuniary relationship (other than remuneration as such director or having transaction not exceeding 10 per cent of his/her total income or such amount as may be prescribed) with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding FYs or during the current FY.

Pecuniary relationship or transaction entered into by a relative has been clearly explained in the Companies (Amendment) Act, 2017. Accordingly, a relative of an Independent Director should not:

a. Hold any security of or interest in the company, its holding, subsidiary or associate company during the two immediately preceding FYs or during the current FY in excess of INR50 lakh or two per cent of the paid-up capital of the company, its holding, subsidiary or associate company or such higher sum as may be prescribed

b. Be indebted to the company, its holding, subsidiary or associate company or their promoters, or directors, in excess of such amount as may be prescribed during the two immediately preceding FYs or during the current FY

c. Give a guarantee or provide any security in connection with the indebtedness of any third person to the company, its holding, subsidiary or associate company or their promoters, or directors of such holding company, for such amount as may be prescribed during the two immediately preceding FYs or during the current FY

d. Have any other pecuniary transaction or relationship with the company, or its subsidiary, or its holding or associate company amounting to two per cent or more of its gross turnover or total income singly or in combination with the transactions referred to in points (a), (b) or (c) above.

Further, an individual is restricted to be appointed as an Independent Director in case his/her relative is a KMP or an employee of the company or its holding, subsidiary or associate company during any of the preceding three FYs. However, such a restriction would not apply if a relative of an Independent Director is employed during the preceding three FYs.

(Emphasis added to highlight the change)

Also refer to 'revised norms for disqualification of directors under the Companies (Amendment) Act, 2017’ on page 43.
Key elements of appointment of an Independent Director

Following are the key elements related to the appointment of an Independent Director under the 2013 Act:

- **Tenure of service of Independent Directors**: An Independent Director is required to hold office for a term up to five consecutive years on the BoD of a company subject to a maximum of two consecutive terms. However, a retiring Independent Director would become eligible for appointment after the expiry of three years from completion of his/her term (cooling-off period). During the cooling-off period, such a director cannot be appointed or be associated with the company in any other capacity, either directly or indirectly.

- **Appointment for a period less than five years**
  
  An Independent Director can be appointed for a term less than five years, however, appointment for any term (whether for five years or less) would be treated as one term under Section 149(10).

  Further, such person would have to demit the office after two consecutive terms even if the total number of years of his/her appointment in such two consecutive terms is less than 10 years. In such a case, the person completing consecutive terms of less than 10 years would be eligible for appointment only after the expiry of the cooling-off period of three years.

- **Declaration of independence**: Every Independent Director is required to provide a declaration of meeting the specified criteria of independence at the first board meeting in which he/she participates as a director and thereafter at the first board meeting in FY or whenever there is a change in the circumstances which could affect his/her status as an Independent Director.

- **Code for Independent Directors**: Schedule IV to the 2013 Act includes a code for Independent Directors. It lays down the guidelines relating to the professional conduct, role and functions, duties of an Independent Director, their manner of appointment, reappointment, resignation or removal and an evaluation mechanism.

  Additionally, it provides that the Independent Directors of a company should hold at least one meeting in a financial year (instead of ‘year’), without the attendance of non-independent Directors and members of management to:

  - Review the performance of non-independent Directors, the board as a whole and Chairperson of the company and
  - 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.

Requirements prescribed under the Listing Regulations

The Listing Regulations prescribe following requirements specifically for an Independent Director of a listed entity:

- **Formulation of a code of conduct (Regulation 17(5))**: The BoD of listed entities are required to formulate a code of conduct for all its members and senior management (including Independent Directors). Such a code should incorporate the duties of the Independent Directors as prescribed under the 2013 Act.

- **Performance evaluation (Regulation 17(10))**: Performance evaluation of Independent Directors should be done by the entire BoD, excluding the director being evaluated.

- **Create awareness about the entity (Regulation 25(7))**: Listed entities are required to familiarise the Independent Directors about the listed entity, including nature of the industry in which it operates, its business model, roles, rights and responsibilities of Independent Directors.
Guidance Note on Board evaluation

The SEBI issued a Guidance Note on Board Evaluation (GN) in January 2017 with the purpose to inform the listed entities and their BoD about the various aspects involved in the process of board evaluation and to improve their overall performance as well as corporate governance standards to benefit all stakeholders.

The GN, inter alia, considers facilitation of the Independent Directors by the board to perform their role effectively as a member of the board and also as a member of a committee and considering criticism of such directors constructively as one of the main functions of the board.

Additionally, it prescribes specific criteria for evaluation of Independent Directors which, inter alia, relates to assessment of their qualification, experience, knowledge and competency, independence, commitment and independent views and judgement.

• Fees of Independent Directors: Independent Directors are not entitled to any remuneration other than fees for attending board or committee meetings, reimbursement of expenses for participation in the board and other meetings and profit related commission as may be approved by the members. Stock options are specifically prohibited to be issued to them.

• Liability of actions: An Independent Director and a non-executive director not being promoter or KMP would be liable only for such acts of omission or commission by a company which had occurred with his/her knowledge, attributable through board processes, and with his/her consent or connivance or where he/she had not acted diligently.

• Data bank of Independent Directors: A company could select its Independent Directors from a data bank. However, the company needs to ensure exercise of due diligence before making such a selection.

Duties of all directors (including Independent Directors)

The 2013 Act specifies the duties of directors in general and for Independent Directors as well. The duties of directors are specified in Section 166 and the duties specifically to be performed by Independent Directors in Schedule IV (Code for Independent Directors).

Duties of Independent Directors specified in the code for Independent Directors (Schedule IV), inter alia, include the following:

• Regular updation of the skills, knowledge and familiarity with the company
• Seeking appropriate clarification, professional advice and opinion of outside experts
• Attending all meetings of the board and the committees
• Ensuring attention and deliberation prior to approving RPTs
• Non-disclosure of any confidential information.

Reporting on IFC

The directors’ responsibility statement requires directors of the listed companies to state whether they had laid down IFC to be followed by the company and that such IFC are adequate and were operating effectively. Additionally, the board’s report is required to state the adequacy of the IFC with respect to financial statements.
Role of directors (including Independent Directors) in constitution of committees

- **CSR committee (Section 135):** Every company that makes a contribution towards CSR is required to constitute a CSR committee which should comprise of three or more directors, out of which at least one director should be an Independent Director.

However, as per the CSR Rules (Rule 5(1)), an unlisted public company/private company which is not required to appoint an Independent Director, should have a CSR committee without an Independent Director.

The CSR committee would be responsible for the formulation and recommendation to the BoD, a CSR policy indicating the activities to be undertaken by the company, recommendation of the amount of expenditure to be incurred on the CSR activities and monitoring of CSR policy from time to time.

- **Audit committee and nomination and remuneration committee (Section 177 and Section 178):** Currently, every listed company and an unlisted public company\(^47\) (except a joint venture, a wholly-owned subsidiary or a dormant company)\(^48\) is required to constitute an audit committee and a nomination and remuneration committee.

As per the Companies (Amendment) Act, 2017, every listed public company and an unlisted public company (except a joint venture, a wholly-owned subsidiary or a dormant company) is required to constitute the following committees:

  - An **audit committee** which should comprise of minimum three directors with majority being Independent Directors.

    The committee would, *inter alia*, be responsible for recommendation of appointment, remuneration, terms of appointment of auditors of the company, review and monitor the auditor’s independence and performance and evaluation of IFCs and risk management systems.

- **Stakeholders’ relationship committee (Section 178(5)):** The BoD of a company with more than 1,000 shareholders, debenture holders, deposit holders and any other security holders at any time during a FY is required to constitute a stakeholders’ relationship committee. The committee should consist of a chairperson who should be a non-executive director and such other members as may be decided by the board.

    The committee would consider and resolve the grievances of security holders of the company.

- A nomination and remuneration committee which should comprise of three or more non-executive directors out of which not less than one-half should be Independent Directors.

    The committee is required to formulate the criteria for determining qualifications, positive attributes and independence of a director and recommend to the board a policy, relating to the remuneration for the directors, KMP and other employees.

**Nomination and remuneration committee to prescribe methodology for BoD evaluation as per the Companies (Amendment) Act, 2017**

Nomination and remuneration committee is required to specify the methodology for the effective evaluation of the performance of the individual directors, committees of the BoD and the BoD as a whole. This evaluation could be carried out by the BoD, by the nomination and remuneration committee or by an independent external agency. The nomination and remuneration committee should review its implementation and compliance.

**Companies required to form audit committee and nomination and remuneration committee as per the Companies (Amendment) Act, 2017**

Every listed public company and an unlisted public company (except a joint venture, a wholly-owned subsidiary or a dormant company) is required to constitute an audit committee and a nomination and remuneration committee.

(Emphasis added to highlight the change)

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47. A public company meeting any of the given criteria is required to constitute the committee:
   - Paid-up share capital of INR10 crore or more

48. MCA general circular no.09/2017 dated 5 September 2017

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Requirements prescribed under the Listing Regulations

In addition to the requirements prescribed under the 2013 Act, the Listing Regulations prescribe following requirements in relation to membership and formulation of the committees by the directors of listed entities:

• **Maximum limit for membership in a committee (Regulation 26):** A director could be a member in 10 committees or could act as a chairperson of five committees across all listed entities in which he is a director.

  While determining the limit of a director to act as a chairperson, following inclusion/exclusions are required:
  a. Include the limit of the committees on which a director could serve in all public limited companies (listed or unlisted)
  b. Exclude all other companies including private limited companies, foreign companies and companies formed under Section 8 of the 2013 Act.

  Additionally, for the purpose of determination of this limit, only chairpersonship and membership of the audit committee and the stakeholders’ relationship committee should be considered.

• **Audit committee (Regulation 18):** The requirements relating to composition of an audit committee are similar to the provisions of the 2013 Act.

  The Listing Regulations additionally provide that the quorum for audit committee meeting should comprise of either two members or one-third members of the audit committee, whichever is greater, with at least two Independent Directors.

  Further, the audit committee would, *inter alia*, be responsible for approval of appointment of CFO and review of the management discussion and analysis of financial conditions and results of operations.

• **Nomination and remuneration committee (Regulation 19):** The requirements relating to composition of a nomination and remuneration committee are similar to the provisions of the 2013 Act.

  Additionally, the role of the nomination and remuneration committee would extend to assessment of whether the term of appointment of the Independent Directors should be extended on the basis of the report of the performance evaluation of Independent Directors.

• **Risk management committee (Regulation 21):** Top 100 listed entities (based on the market capitalisation as at the end of the immediate previous FY) are required to constitute a risk management committee. The majority members of the committee should comprise of members of BoD including its chairperson.

  The BoD is required to define the role and responsibility of the risk management committee. It should also delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit.
Additional responsibilities of the directors

The 2013 Act endows crucial responsibilities to the BoD, non-compliance with such responsibilities expose the officers who would be in default\(^49\) to severe punishments. Some of these responsibilities are as follows:

- **Approval of the financial statements (Section 134(1))**: Financial statements (including CFS) of a company are required to be approved by the BoD.

- **Disclosure of interest (Section 184)**: Every director is required to disclose his/her concern or interest (including their shareholding) in any company, corporate, firms or other association of individual in the board meeting.

- **Matters to be included in the board’s report (Section 134(3))**: The financial statements of a company should accompany a report by its board of directors which, *inter alia*, includes the following statements:
  - **Directors’ responsibility statement**: A declaration by the directors assenting performance of various obligations such as preparation of annual accounts on a going concern basis, consistent application of accounting policies, adequacy and the effectiveness of the internal financial control (discussed under ‘Reporting on internal financial controls’), etc.
  - **Risk management policy**: Indicate development and implementation of risk management policy for the company including identification of elements of risk, if any, which in the opinion of the board could threaten the existence of the company.

- **CSR policy**: Indicate development and implementation of the CSR initiatives taken during the year.

- **Board evaluation**: Indicate the manner in which formal annual evaluation has been made by the board of its own performance, its committees and individual directors.

- **Prohibition on loan to directors (Section 185)**: A company is not allowed to give a loan (directly or indirectly) to any of its directors or to any other person in whom the director is interested. However, a loan could be given to a MD or a WTD, if the amount falls in either of the given categories:
  - Part of the conditions of service extended by the company to all its employees, or
  - Pursuant to any scheme approved by the members by a special resolution.

- **Filing of annual return (Section 92(1))**: Every company is required to prepare and file an annual return with the ROC containing the particulars as they stood on the close of the FY.

- **Buy-back of securities (Section 68(6))**: A company which proposes to buy-back its shares, should file with the ROC and SEBI a declaration of solvency signed by at least two directors of the company. It should also be verified by an affidavit to the effect that the BoD of the company has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and the company will not be rendered insolvent within a period of one year from the date of declaration adopted by the board.

\(^49\) Officer who is in default, *inter alia*, means any of the following officers of a company who should be liable to any penalty or punishment by way of imprisonment, fine or otherwise under the provisions of the 2013 Act:

a. WTD
b. KMP and
c. In case of no KMP, directors as specified by the board.
Listing Regulations also prescribe various responsibilities over the BoD which are in line with the provisions of the 2013 Act. Some of the additional responsibilities that it encompasses are as follows:

- **Disclosure of material interest (Regulation 4(2)(f)(i))**: The members of the BoD and the KMP should disclose any direct or indirect material interest in any transaction or matter affecting the listed entity.

- **Maintain operational transparency (Regulation 4(2)(f)(i))**: The BoD and senior management\(^{50}\) should ensure operational transparency at all times in their conduct and maintain confidentiality of information so as to foster a culture of good decision-making.

- **Alignment of remuneration (Regulation 4(2)(f)(ii))**: BoD is authorised to align the KMP and the remuneration of the BoD with the longer term interest of the entity and its shareholders.

- **Ability to step back (Regulation 4(2)(f)(iii))**: The BoD should have the ability to step back to assist executive management by challenging the assumptions underlying: strategy, strategic initiatives (such as acquisitions), risk appetite, exposures and the key areas of the listed entity’s focus.

- **Enable functioning of Independent Directors (Regulation 4(2)(f)(iii))**: The BoD and the senior management should facilitate the Independent Directors to perform their role effectively as a member of the board of directors and its committee.

- **Periodic review of compliance reports (Regulation 17(3))**: The BoD should periodically review the compliance reports pertaining to the laws applicable to the listed entity as well as steps taken to rectify instances of non-compliance.

### Ineligibility of appointment/reappointment of a director

Directors are required to ensure compliance with the responsibilities entrusted under the 2013 Act. Additionally, Section 164 of the 2013 Act specifically provides the cases where:

- The directors would not be considered eligible to be appointed as a director or
- If already appointed, then would not be eligible to be reappointed as a director of that company or other company.

Events that could lead to a director being ineligible to be appointed, *inter alia*, include the following:

- a. Disqualification by an order of a court or Tribunal
- b. Non-payment of any calls on the shares held by the director
- c. Conviction on account of any offence dealing with RPTs at any time during the last preceding five years
- d. Non-allocation of Director Identification Number (DIN)
- e. Non-filing of financial statements or annual returns for any continuous period of three FYs\(^{51}\)
- f. Failure to repay the deposits accepted by it or interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared for a continuous period of one year\(^{51}\).

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50. Senior management should mean officers/personnel of the listed entity who are members of its core management team excluding board of directors and should comprise all members of management one level below the executive directors including all functional heads.

51. In such a case, a director would not be eligible to be reappointed for a period of five years from the date on which the said company fails to file the financial statements/annual returns or repay the deposits, dividend, redeem debentures/interest thereon.
Revised norms for disqualification of directors under the Companies (Amendment) Act, 2017

The Companies (Amendment) Act, 2017 has clarified that in case a person has been appointed as a director of a company which has defaulted in filing of financial statements/annual returns and repayment of the dues (points (e) and (f) above), then such a director would not incur the disqualification for a period of six months from the date of his/her appointment. In case a director gets disqualified due to default in filing of financial statements/annual returns or repayment of dues, then the office of the director would become vacant in all the companies other than the company which is in default.

Also, a director would continue to remain disqualified if he/she has been convicted by a court for any offence, on the order of the Tribunal and convicted in the matter of RPTs, even if an appeal or petition has been filed against the order of conviction or disqualification.

Additionally, the Companies (Amendment) Act, 2017 provides that vacation of office in respect of disqualification by an order of a court or the Tribunal or conviction for any offence would not take place in the following scenarios:

a. For 30 days from the date of conviction or order of disqualification

b. Where an appeal or petition is preferred within 30 days as aforesaid against the conviction resulting in sentence or order, until expiry of seven days from the date on which such appeal or petition is disposed of, or

c. Where any further appeal or petition is preferred against order or sentence within seven days, until such further appeal or petition is disposed of.

Remuneration of directors

Remuneration payable by companies with profits

As per Section 197 of the 2013 Act, total managerial remuneration payable by a public company, to its directors (including MD and WTD) and its manager in respect of any FY should not exceed 11 per cent of the net profits of the company for that FY computed in the manner specified in Section 198 of the 2013 Act (remuneration of the directors should not be deducted from the gross profits of the company).

Authorisation for payment of remuneration under the Companies (Amendment) Act, 2017

The company in a general meeting may authorise the payment of remuneration exceeding 11 per cent of the net profits of the company, subject to Schedule V of the 2013 Act. The requirement for a CG approval has been dropped.

The Companies (Amendment) Act, 2017 clarifies that while calculating net profits of the company for the purpose of determining managerial remuneration payable, any amount representing unrealised gains, notional gains or revaluation of assets have to be excluded from net profits. Any amount representing profits by way of premium on shares or debentures of the company, which are issued or sold by an investment company should not be excluded from the net profits.

Additionally, any application made to the CG under the provisions of Section 197 (before commencement of the Companies (Amendment) Act, 2017) and is pending with the CG on the date of its commencement would abate, and the company is required to obtain the approval in accordance with the amended provisions of this section, within one year of the commencement of the Companies (Amendment) Act, 2017.

52. Remuneration means any money or its equivalent given or passed to any person for services rendered by him and includes perquisites as defined under the Income-tax Act, 1961.
Following table provides the maximum amount of remuneration payable when there are one or more than one MD, WTD or manager in the company:

<table>
<thead>
<tr>
<th>Remuneration payable to</th>
<th>Should not exceed*</th>
</tr>
</thead>
<tbody>
<tr>
<td>When there is one MD, WTD or a manager</td>
<td>5 per cent of net profits</td>
</tr>
<tr>
<td>When there is more than one MD, WTD or manager</td>
<td>10 per cent of net profits (to all such directors and manager taken together)</td>
</tr>
<tr>
<td>Directors (other than MD or WTD)</td>
<td>1 per cent of net profits (if there is a MD or WTD or manager)</td>
</tr>
<tr>
<td></td>
<td>3 per cent of net profits (in other case)</td>
</tr>
</tbody>
</table>

(Source: KPMG in India’s analysis, 2018 based on the provisions of Section 197 of the 2013 Act)

*These percentages would be exclusive of any fees payable to directors.

**Revised norms for payment of managerial remuneration under the Companies (Amendment) Act, 2017**

When there are one or more than one MD, WTD or manager in the company, approval of shareholders by a special resolution would be required to pay managerial remuneration in excess of the maximum amount of remuneration prescribed (as explained in table above).

Additionally, in case a company has defaulted in payment of dues to any bank/public financial institution/non-convertible debenture holders/secured creditor, then prior approval of such bank/public financial institution/non-convertible debenture holders/secured creditor should be obtained before obtaining the approval in the general meeting.

**Remuneration payable by companies with inadequate or no profits**

In case a company has no profits or its profits are inadequate in any FY, then level of remuneration payable is dependent on certain thresholds as defined in the Schedule V to the 2013 Act. The Schedule V buckets managerial remuneration into two categories, and they are as follows:

a. Those that do not meet the criteria for a ‘professional capacity’ as defined in Schedule V to the 2013 Act

b. Those that meet the criteria for ‘professional capacity’ as defined in Schedule V to the 2013 Act.

**Managerial personnel not functioning in a professional capacity**

For a managerial personnel not meeting the criteria for a professional capacity, a company with no or inadequate profits could pay remuneration based on the effective capital of the company which should not exceed the limits specified below:

<table>
<thead>
<tr>
<th>Where the effective capital is</th>
<th>Limit of yearly remuneration payable should not exceed*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negative or less than INR5 crore</td>
<td>INR60 lakh</td>
</tr>
<tr>
<td>INR5 crore and above but less than INR100 crore</td>
<td>INR84 lakh</td>
</tr>
<tr>
<td>INR100 crore and above but less than INR250 crore</td>
<td>INR120 lakh</td>
</tr>
<tr>
<td>INR250 crore and above</td>
<td>INR120 lakh plus 0.01 per cent of the effective capital in excess of INR250 crore</td>
</tr>
</tbody>
</table>

(Source: KPMG in India’s analysis, 2018 based on the provisions of Schedule V to the 2013 Act)

*Limits specified can be doubled if a special resolution is passed.

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53. The remuneration in excess of these limits could be paid with the approval of the shareholders in a general meeting by passing a special resolution.
Managerial personnel functioning in a professional capacity

If the managerial personnel is functioning in a professional capacity and possesses graduate level qualification with an expertise and specialised knowledge in the field in which the company operates then approval of the CG is not required if such managerial person, at any time during the last two years before or on or after the date of appointment does not have:

a. Any interest in the capital of the company/its holding company/any of its subsidiaries directly or indirectly or through any other statutory structures
b. Any direct/indirect interest or related to the directors/promoters of the company or its holding company/any of its subsidiaries.

Any employee of a company holding shares of the company not exceeding 0.5 per cent of its paid-up share capital under any scheme formulated for allotment of shares to such employees including Employees Stock Option Plan (ESOP) or by way of qualification should be deemed to be a person not having any interest in the capital of the company.

Additionally, following are the conditions which a company needs to satisfy to apply the remuneration for situations where it has inadequate or no profits:

a. Resolution to be passed: Payment of remuneration should be approved by the resolution passed by the board and in the case of a company covered under Section 178(1) of the 2013 Act and also by the Nomination and Remuneration Committee.

An ordinary resolution would be required to be passed for payment of remuneration as per limits specified for managerial personnel not meeting the criteria of a professional and a special resolution is required to be passed, if these limits are to be doubled, at the general meeting of the company for a period not exceeding three years.

A special resolution is required to be passed for payment of remuneration to a managerial personnel functioning as a professional, at the general meeting of the company for a period not exceeding three years.

b. Default in payment of debt: A company has not committed any default in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of 30 days in the preceding FY before the date of appointment of such managerial person. In case of default, the company obtains prior approval from secured creditors for the proposed remuneration and the fact of such prior approval has been obtained and is mentioned in the explanatory statement to the notice convening the general meeting.

c. Notice: A statement along with a notice calling the general meeting should be given to the shareholders containing the specified information.

Revised norms for payment of managerial remuneration in case of no profits/ inadequate profits under the Companies (Amendment) Act, 2017

In case of no profits/inadequate profits in any FY, a company should not pay to its directors (including any MD or WTD or manager) by way of remuneration any sum (exclusive of any fees payable to directors), except in accordance with the provisions of Schedule V. The provision of approval of CG for payment in excess of Schedule V has been omitted.

Additionally, in cases where Schedule V is applicable on grounds of no profits or inadequate profits, any provision relating to the remuneration of any director which purports to increase or has the effect of increasing the amount thereof, whether the provision be contained in the company’s memorandum or articles, or in an agreement entered into by it, or in any resolution passed by the company in general meeting or its Board, should not have any effect unless such increase is in accordance with the conditions specified in Schedule V. The provision relating to CG approval, in case conditions of Schedule V are not complied with, has been omitted.

Remuneration in excess of specified limits without CG approval

A company could, without CG approval, pay remuneration to a managerial person in excess of the amounts provided for companies with no profits or inadequate profits subject to specified conditions, in the following circumstances:

- Excess remuneration has been paid by any other company.
  - Such other company is either a foreign company or has got the approval of its shareholders in general meeting to make such payment.
  - The other company 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 is within permissible limits under Section 197.
- Newly incorporated company for a period of seven years from the date of its incorporation
- Sick company for whom a scheme of revival or rehabilitation has been ordered by the Board for Industrial and Financial Reconstruction (BIFR) or NCLT, for a period of five years from the date of sanction of scheme of revival
- Remuneration has been fixed by the BIFR or the NCLT.

**Norms for refund of excess remuneration under the Companies (Amendment) Act, 2017**

In case any director draws or receives remuneration in excess of the specified threshold, then he/she should refund the amount within two years or such lesser period as may be allowed by the company.

The company should not waive the recovery of any sum refundable to it unless approved by the company by special resolution within two years from the date the sum becomes refundable. However, where the company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, should be obtained by the company before obtaining approval of such waiver.

**Auditor’s report on compliance with remuneration norms**

An auditor is required to make a statement as to whether the remuneration paid by the company to its directors is in accordance with the prescribed provisions as per the Companies (Amendment) Act, 2017.

**Disclosure in board’s report**

The board’s report of every listed company is required to disclose certain key elements with respect to the remuneration payable to directors. These, *inter alia*, include a ratio of remuneration of each director to the median remuneration of the employees of the company for the FY, percentage increase in remuneration of each director in the FY, etc.

**Additional disclosure under the Companies (Amendment) Act, 2017**

**Placement of remuneration policy:**

Companies should place their remuneration policy on its website, if any, and should disclose only the salient features of the policy, the changes, if any along with the web address of the policy in the board’s report.

**Requirements prescribed under the Listing Regulations**

**Remuneration to directors (Regulation 17(6)):** The BoD of a listed entity are required to recommend all fees or compensation, if any paid to the non-executive directors including Independent Directors and should obtain approval of shareholders in general meeting. Shareholders’ approval is not required for payment of sitting fees to non-executive directors, if paid within the limits specified under the 2013 Act (for payment without approval of the CG).

**Retirement of directors by rotation**

The 2013 Act specifically provides that not less than two-thirds of the total number of directors (excluding Independent Directors) of a public company should be persons whose period of office is liable to determination by retirement of directors by rotation and be appointed by the company in general meeting. However, the articles of a company could provide for retirement of all directors at every AGM.

The company may fill up the vacancy by appointing the retiring director or some other person at every AGM at which a director retires.

**Revised norms for casual vacancy of a director under the Companies (Amendment) Act, 2017**

If the office of any director appointed by the company in the general meeting is vacated before his/her term of office expires in the normal course, the resulting casual vacancy could be filled by the BoD in its meeting. This is applicable to every company provided such an appointment gets an approval in the immediate next general meeting.
Vacation of office of director

Section 167 of the 2013 Act provides a list of situations in which an office of a director should mandatorily get vacated. These, *inter alia*, includes vacation on account of disqualification of a director, failure to disclose interest in contracts or arrangements in which he/she has direct/indirect interest, etc.

A private company through its articles could provide additional grounds for vacation of the office of a director.

Resignation of a director

A director of a company could resign by giving a prior notice in writing to the company. The board should intimate the ROC after taking note of the resignation and should also place the fact of such resignation in the report of directors laid in the immediately following general meeting of the company.

Submission of resignation to the ROC is not mandatory under the Companies (Amendment) Act, 2017

A director is not mandatorily required to forward a copy of his resignation along with detailed reasons to the ROC.

The resignation would come into effect from the date on which the notice is received by the company or such other date as specified by the director in the notice, whichever is later.

The director would continue to be liable for the offences which has occurred during his/her tenure after his resignation.

Removal of a director

A company could remove a director (not being a director appointed by the Tribunal) before the expiry of his tenure by passing an ordinary resolution and after providing reasonable opportunity of being heard.

Vacancy created by the removal of a director should be filled by the company or by the board by appointing another director in the removed director’s place at the meeting at which he/she has been removed. However, a special notice for any resolution to remove a director or to appoint a person in place of the director so removed would be required.

It is important to note that an Independent Director who has resigned or has been removed from the board of the company should be replaced by a new Independent Director within three months from the date of such resignation or removal54.

Requirements prescribed under the Listing Regulations

The Listing Regulations does not contain specific provisions for the retirement, resignation or removal of a director (other than an Independent Director which is similar to the 2013 Act).

Consider this

- An Independent Director is required to hold office for a term up to five consecutive years on the BoD of the company subject to a maximum of two consecutive terms.
- A person is not allowed to serve as an Independent Director in more than seven listed entities as per the Listing Regulations.
- An Independent Director includes a director who has/had no pecuniary relationship with the company, its holding/subsidiary/associate company/their promoters/directors. The Companies (Amendment Act), 2017 specifically excludes the amount of remuneration received by an Independent Director and any transaction up to 10 per cent of his/her total income from the definition of pecuniary relationship.

Additionally, the Companies (Amendment) Act, 2017 has modified the scope of restriction on a ‘pecuniary relationship or transaction’ entered by a relative by clearly categorising them into types of transactions. These restrictions are in relation to holding of a security or interest, indebtedness, providing guarantee or security in connection with the indebtedness of any third person to the company, its holding, subsidiary or associate company.

- An individual is restricted from being appointed as an Independent Director in case he/she or his/her relative is a KMP or an employee of the company or its holding, subsidiary or associate company during any of the preceding three FYs. However, as per the Companies (Amendment) Act, 2017, this restriction would not apply if a relative of an independent director is employed during the preceding three FYs.
- An Independent Director would be liable only for such acts of omission or commission by a company which had occurred with his knowledge, attributable through BoD processes, and with his consent or connivance or where he had not acted diligently.
- BoD members are required to disclose their shareholding (held by them or on behalf of others) in a listed entity in which they are proposed to be appointed as directors.
- Currently, Section 185 of the 2013 Act specifically prohibits a company from providing any loan/guarantee/security to its directors or to any other person in whom the director is interested.

However, the Companies (Amendment) Act, 2017 allows a company to give loans/guarantee/security to any person in whom any of its director is interested when two conditions are fulfilled. One, a special resolution has been passed and two, the loan is to be utilised by the borrowing company for its principal business activities.

- Every listed public company and unlisted public companies (meeting certain thresholds) are required to form an audit committee and a NRC as per the Companies (Amendment) Act, 2017. It seems that listed private companies do not have to form an audit committee and a NRC.

Additionally, NRC is required to specify the methodology for the effective evaluation of the performance of the individual directors, committees of the board and the board as a whole which should be carried out by the board, by the NRC or by an independent external agency. The NRC should review its implementation and compliance.

- Top 100 listed companies (based on the market capitalisation) are required to constitute a risk management committee in addition to other committees.
- The 2013 Act and the Listing Regulations pose challenges in the form of onerous responsibilities of the directors. Directors should ensure compliance with the prescribed requirements else severe prosecutions and penalties could follow.
Declaration and payment of dividend

Dividend is a return given to the shareholders who have invested capital in the company.

Companies are required to comply with the provisions of the 2013 Act for the declaration and payment of dividends. The 2013 Act extends the definition of dividend to include interim dividend in it.

A company can pay dividend out of the following sources:

a. From current year’s profits
b. From profits of any previous FY remaining undistributed, or
c. From (a) and (b) both,
d. From its free reserves (in case of inadequate or no profits).

Declaration/payment of dividend from the profits

A company could declare or pay dividend out of its profits for the current year or profits for any previous FYs. However, before declaring any dividends, the companies are required to make following adjustments to the profits which would be available for distribution as dividends:

a. Make a provision for depreciation (in accordance with Schedule II to the 2013 Act)
b. Set-off carried over previous losses and depreciation not provided in the previous year(s) against its profits for the current year.
The 2013 Act also mentions that a company may, before declaration of any dividend in any FY, transfer a certain percentage of its profits for that FY as it may consider appropriate to the reserves of the company. It is important to note that Section 205 of the 1956 Act provided a mandatory requirement for transfer of profits to general reserve before declaration of dividend. Therefore, it might be a prudent practice to transfer an appropriate percentage of profits to reserves before the declaration of any dividend. The BoD of a company have a discretion to decide whether certain percentage of profits should be transferred to reserves before declaration of dividend in a FY.

Additionally, the 2013 Act reiterates that dividend should be declared or paid by a company only from its free reserves.

Interim dividend
An interim dividend could be declared during any FY out of the following sources:

- Surplus in the statement of profit and loss and
- Profits of the FY in which such interim dividend is sought to be declared.

However, in case a company has incurred loss up to the end of the quarter (current FY) immediately preceding the date of declaration of interim dividend, then the interim dividend should not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three FYs.

Declaration of interim dividend under the Companies (Amendment) Act, 2017
The BoD of a company can declare interim dividend during any FY or at any time during the period from closure of FY till holding of the AGM.

Additionally, an interim dividend could be declared out of the profits generated in the FY till the quarter preceding the date of declaration of the interim dividend.

Declaration/payment of dividend from the reserves
When a company has inadequate profits or loss in any year, then the company can declare dividend out of the accumulated profits earned by it in the PYs and transferred by it to the free reserves, subject to the following conditions:

a. Reserves mean free reserves: Dividend should be declared or paid out of free reserves only.

b. Maximum rate of dividend: The rate of dividend should not exceed average of the rates at which dividend was declared by the company in the immediately preceding three years. This condition would not be applicable to a company which has not declared any dividend in each of the three preceding FYs.

c. Maximum amount to be withdrawn: The total amount to be withdrawn from the accumulated profits should not exceed one-tenth of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statements.

d. Utilisation of amount withdrawn: The amount withdrawn should be first utilised to set-off the losses incurred in the FY in which dividend is declared before any dividend in respect of equity shares is declared.

e. Maintain adequate balance in reserves: The balance of reserves should not fall below 15 per cent of its paid-up share capital as appearing in the latest audited financial statement, after such withdrawal.

55. Free reserves means reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend except the following:
   a. Any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or
   b. Any change in carrying amount of an asset or of a liability recognised in equity, including surplus in the statement of profit and loss on measurement of the asset or the liability at fair value.
Free reserves and Ind AS transition adjustments

Section 123 of the 2013 Act and the related Rules seem to ease the process of declaration and payment of dividend along with safeguarding the interest of the shareholders. However, additional input is required from MCA to deal with the meaning of free reserves and Ind AS transition adjustment to retained earnings in the year of transition.

As per the provisions of the 2013 Act, in case of inadequate or no profits, dividend could be paid out of free reserves only.

Free reserves means reserves which are available for distribution as dividend as per the latest audited balance sheet of a company. However, the definition excludes any unrealised gains, notional gains or revaluation of assets (whether shown as reserves or otherwise) or change in carrying amount of asset/liability recognised in equity reserves from its definition.

With Ind AS being applicable to the companies, there seems to be an ambiguity with the treatment of certain adjustments. For instance, uncertainty over the treatment of adjustments to retained earnings on first-time adoption of Ind AS whether such adjustments would be considered while computing free reserves. Similarly, if accumulated losses convert into profits due to first-time adoption adjustments then would such adjustments be considered as part of free reserves and would be available for distribution of dividend or whether any adjustments would be required to be made to the profits computed under Ind AS.

General conditions for declaration and payment of dividend

A company declaring or paying dividend (whether from profits or reserves) is required to comply with these additional conditions:

a. Ensure compliance with Section 73 and 74 of the 2013 Act: A company would not be able to declare any dividend on the equity shares, if it fails to comply with the provisions of Section 73 (acceptance of deposits from members and public) and Section 74 (repayment of deposits) of the 2013 Act till the time such failure continues.

b. Proportional dividend: A company could pay dividends in proportion to the amount paid-up on each share subject to authorisation by its articles.

c. Deposit dividend in a separate bank account: The amount of dividend (including the interim dividend) should be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend.

d. Pay only to a registered shareholder: Dividend should be paid only to a registered shareholder or on the order of such a shareholder, to the banker in cash. However, the 2013 Act does not prohibit the capitalisation of profits or reserves of the company for issuing fully paid-up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company.

e. Mode of payment of dividend: Dividend payable in cash could be paid by cheque, warrant or in any electronic mode to the shareholder entitled to the payment of dividend.

f. Unpaid dividend account: Dividend declared but not paid or claimed within 30 days from the date of declaration to any shareholder, should be transferred to a special account in any scheduled bank called as ‘unpaid dividend account’ within seven days from the date of expiry of 30 days.

Additionally, the company is required to prepare a statement containing the details of the amount remaining unpaid within 90 days from the date of making transfer to the unpaid dividend account and should place it on the website of the company.

In case of default in transferring the amount or any part of the dividend to the unpaid dividend account, an interest at the rate of 12 per cent per annum would be required to be paid by the company on the amount not transferred.

g. Investor Education and Protection Fund (IEPF): The amount transferred to the unpaid dividend account but remaining unpaid or unclaimed for a continuous period of seven years should be transferred to the IEPF. Additionally, all the shares in respect of which dividend has not been paid or claimed for the seven consecutive years should be transferred to the IEPF.

However, in case any dividend has been paid or claimed for any year during the period of seven consecutive years, then the share should not be transferred to the IEPF.

The company is required to send a statement comprising the details of the amount and share transferred in the IEPF in the prescribed form to the authority that administers the IEPF.

h. Disclosure in board’s report: BoD are required to disclose the amount which the company proposes to carry to its reserves and the amount of dividend which it recommends should be paid in its report.
Requirements prescribed under the Listing Regulations

The Listing Regulations prescribe the following in relation to declaration and payment of dividend by:

**Equity listed entities**

- **Declaration on per share basis (Regulation 43(1))**: Dividends should be disclosed on per share basis only.

- **Record date (Regulation 42(1))**: Listed entities are required to intimate the record date to all the stock exchange(s) where it is listed for various purposes including for declaration of dividend.

- **Declaration of dividend (Regulation 42(3))**: Listed entities should recommend or declare all dividend at least five working days (excluding the date of intimation and the record date) before the record date fixed for the purpose.

- **Formulation of dividend distribution policy (Regulation 43A)**: The top 500 listed entities (based on the market capitalisation) are required to formulate a dividend distribution policy which should be disclosed in their annual report and on their websites. The policy should disclose the following parameters:
  a. Circumstances under which the shareholders of the listed entities may or may not expect dividend
  b. Financial parameters that should be considered while declaring dividend
  c. Internal and external factors that should be considered for declaration of dividend
  d. Policy as to how the retained earnings should be utilised and
  e. Parameters that should be adopted with regard to various classes of shares.

  If the listed entity proposes to declare dividend on the basis of the parameters other than specified above or proposes to change such additional parameters, it should disclose such changes along with the rationale in its annual report and on its website.

  Listed entities (other than top 500 listed entities) could disclose their dividend distribution policies on a voluntary basis in their annual reports and on their websites.

- **Forfeiture of dividend not allowed (Regulation 43(2))**: A listed entity is not allowed to forfeit unclaimed dividends before the claim becomes barred by law and such forfeiture, if effected should be annulled in appropriate cases.

- **Transfer to IEPF (Regulation 43(2))**: The unclaimed dividend should be transferred to the IEPF as per the provisions of the 2013 Act.

- **Financial results (Part A of Schedule IV)**: Equity listed entities are required to disclose the following in respect of dividends paid or recommended for the year including interim dividends:
  a. Amount of dividend distributed or proposed for distribution per share; distinguish the amounts in respect of different classes of shares and indicate the nominal values of shares
  b. Where dividend is paid or proposed to be paid pro-rata for shares allotted during the year, the date of allotment and number of shares allotted, pro-rata amount of dividend per share and the aggregate amount of dividend paid or proposed to be paid on pro-rata basis.
Debt listed entities

• **Disclosure of information having a bearing on performance (Regulation 51(1))**: The listed entity should promptly inform the stock exchange(s) of all the information having on the performance/obligation of the listed entity, price sensitive information or any action that should affect payment of interest or dividend of non-convertible preference shares or redemption of non-convertible debt securities or redeemable preference shares.

• **Financial results (Regulation 52)**: The BoD of a debt listed entity are required to address the modified opinion in auditors’ reports that have a bearing on the interest payment/dividend payment pertaining to non-convertible redeemable debentures/redeemption or principal repayment capacity of the listed entity.

Further they are required to disclose the following line items relating to dividend in their financial results (half-yearly/annual as the case may be):

a. Previous due date for the payment of interest/dividend for non-convertible redeemable preference shares/repayment of principal of non-convertible preference shares/non-convertible debt securities and whether the same has been paid or not and

b. Next due date for the payment of interest/dividend of non-convertible preference shares/principal along with the amount of interest/dividend of non-convertible preference shares payable and the redemption amount.

Additionally, disclose the track record of dividend payment on non-convertible redeemable preference shares in the notes to the financials results.

• **No dividend in case of default (Regulation 61(1))**: The listed entity is not required to declare or distribute any dividend wherein it has defaulted in payment of interest on debt securities or redemption or in creation of security as per the terms of the issue of debt securities.

This is not applicable in case of unsecured debt securities issued by regulated financial sector entities eligible for meeting capital requirements as specified by the respective regulators.

Right to dividend when transfer of shares is pending

In case, any instrument of transfer of shares has been delivered to any company for registration but the company fails to register the transfer of such shares, then the company is required to comply with the following:

a. Transfer the dividend in relation to such shares to the unpaid dividend account until the registered shareholder authorises the company to pay such dividend to the transferee specified in the instrument of transfer

b. Keep in abeyance any offer of rights shares and any issue of fully paid-up bonus shares in respect to such shares.

56. In case the dividend has been deferred at any time, then the actual date of payment should be disclosed.
Penal provisions for default in payment of dividend

In case a company fails to pay the dividend or does not post the warrant to any shareholder entitled to the payment of the dividend within 30 days from its declaration, then every director of the company would be punishable with:

- **Imprisonment**: Up to two years and
- **Fine**: Not less than INR1,000 for every day during which such default continues.

Additionally, company would be liable to pay simple interest at the rate of 18 per cent per annum during the period for which such default continues.

However, following situations would not be considered as default in payment of dividend:

- Dividend could not be paid by reason of the operation of any law
- Shareholder gave directions to the company for payment of dividend which could not be complied
- Dispute regarding right to receive the dividend
- Adjustment of dividend by the company against any sum due from the shareholder
- Any other reason (the failure to pay dividend or to post the warrant within the period was not due to any default on the part of the company).

Consider this

- The Companies (Amendment) Act, 2017 clarifies that while computing profits of the company for declaration and payment of dividend, any amount representing unrealised gains, notional gains or revaluation of assets and any changes in carrying amount of an asset or of a liability on measurement of the asset or the liability at fair values should be excluded.
- Interim dividend could be declared out of the profits generated by the company in a FY till the quarter preceding the date of its declaration and can be declared at any time till the date of the AGM.
- Interim dividend should not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three FYs, in case the company has incurred loss up to the end of the quarter (current year) immediately preceding the date of declaration of interim dividend.
- There is no mandatory rule for transfer of profits to reserves before declaration of dividend.
Inter-corporate loans and investments are important sources of funds for every company. The 2013 Act contains stringent provisions for providing loans to directors and companies in which directors are interested. Additionally, it provides guidance on loans, securities and guarantees given to subsidiaries.

Companies can also make investments in other entities as per Section 186 of the 2013 Act.

Restriction on loans to directors by a company (Section 185 of the 2013 Act)

A company cannot advance any loan, including loan represented by a book debt, directly or indirectly to any of its directors. Such a restriction also extends to any guarantee given or security provided in connection with a loan. However, in certain situations, companies are allowed to advance loan or provide guarantee/security.
Loans can be advanced to any person in whom a director is interested under the Companies (Amendment) Act, 2017

Companies are allowed to give loans (including loan represented by a book debt), any guarantee or can provide any security in connection with any loan, to any person in whom any of the director is interested\(^\text{57}\) subject to prior approval by a special resolution and loans should be utilised by the borrowing company for its principal business activities.

Additionally, the notice of the meeting (in which approval is sought) should include an explanatory statement which should disclose full particulars of the loan/guarantee/security provided and the purpose for which the loan/guarantee/security is proposed to be utilised by the recipient and any other relevant fact.

As mentioned above, companies are allowed to advance loan or provide any guarantee in the following scenarios:

- **Loan given by a private company**\(^\text{59}\): No restriction on loan given by a private company, if it meets all the given conditions:
  a. No other body corporate has invested in its share capital
  b. Its borrowings from banks/financial institutions/any body corporate is less than twice of its paid-up share capital or INR50 crore, whichever is lower
  c. No default in repayment of such borrowings subsist at the time of making transactions under Section 185 of the 2013 Act.

- **Loan to MD/WTD**: Any loan given to a Managing Director (MD) or a Whole-Time Director (WTD) provided the amount of loan has been given as a part of conditions of service extended by the company to all its employees or has been given in pursuance of any scheme approved by the members by a special resolution.

Revised norm for loan given in normal course of business as per the Companies (Amendment) Act, 2017

A company is allowed to provide loans or give guarantees or securities in its ordinary course of business for the due repayment of any loan at an interest rate not less than the rate of prevailing yield of one year, three year, five year or 10 year government security closest to the tenor of the loan.

- **Loan/guarantee by a holding company to it wholly-owned subsidiary**: Any loan, guarantee or security given by a holding company to its wholly-owned subsidiary subject to the condition that the amount of loan should be utilised by the subsidiary only for its principal business activities.

- **Guarantee for loan taken by a subsidiary from bank**: Any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary subject to the condition that the amount of loan should be utilised by the subsidiary only for its principal business activities.

**Investments by a company (Section 186 of the 2013 Act)**

In India, companies can make investments in assets or other entities subject to the requirements of the 2013 Act. The following are the conditions:

a. **Investments through two layers of investment companies**: A company is not allowed to make investment through more than two layers of investment companies\(^\text{59}\). However, the restriction of two layers of investment companies\(^\text{59}\) is not applicable in the following cases:

i. A company acquires any other company incorporated in a country outside India if such other company has investment subsidiaries beyond two layers as per the laws of such country

ii. A subsidiary company with any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force.

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57. Any person in whom any of the director of the company is interested means:
   i. Any private company of which any such director is a director or member
   ii. Any body corporate at a general meeting of which not less than 25 per cent of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together
   iii. Any body corporate, the BdD, MD or manager, whereof is accustomed to act in accordance with the directions or instructions of the BdD, or of any director or directors, of the lending company


59. CLC and the Companies (Amendment) Bill, 2016 proposed to remove the restriction. However, MCA through a notification (no. G.S.R. 1176(E)) dated 20 September 2017, decided to continue with the requirement for making investment through not more than two layers of investment companies.

60. An “investment company” means a company whose principal business is the acquisition of shares, debentures or other securities and a company would be deemed to be principally engaged in the business of acquisition of shares, debentures or other securities, if its assets in the form of investment in shares, debentures or other securities constitute not less than 50 per cent of its total assets, or if its income derived from investment business constitutes not less than 50 per cent as a proportion of its gross income. (Companies (Amendment) Act, 2017)
Additionally, the restriction for two layers of investment companies will not be applicable to the following class of companies:

i. A banking company
ii. A systematically important NBFC registered with RBI
iii. An insurance company
iv. A government company.

It is important to note that proviso to Section 2(87) of the 2013 Act allows specified class of companies to have up to two layers of subsidiaries (excluding one or more wholly-owned subsidiary(ies)) whereas, Section 186(1)) provides that the company is not allowed to make investment through more than two layers of investment companies. Section 2(87) is a pervasive section and would apply to all classes of companies including investment companies (covered in Section 186(1)).

Section 186(1) of the 2013 Act earlier allowed a parent company to form two layers of investment companies, while there was no restriction on the number of operating companies. With the application of the proviso to Section 2(87) (notified with effect from 20 September 2017), a company cannot form more than three layers (assuming one layer is a wholly-owned subsidiary) of companies for both operating and investment companies. If, however, first subsidiary is not a wholly-owned subsidiary then the parent company cannot have more than two layers of investment and operating companies.

b. Maximum rate of interest: The rate of interest on loan should not be lower than the prevailing yield of one year, three year, five year or 10 year government security closest to the tenor of the loan.

c. No default in repayment of deposits: The company is not allowed to give any loan/guarantee/security or make any acquisition if it has defaulted in the repayment of any deposits accepted before or after the commencement of the 2013 Act or payment of interest thereon till such default is subsisting.

d. Investments to be in held in the company’s own name: All investments made or held by a company in any property, security or other asset should be in the company’s own name except shares in subsidiary which could be in the name of any nominee or nominees of the company to ensure that the number of members of subsidiary is not reduced below the statutory limit.

However, this provision will not prevent a company from undertaking the following transactions:

a. Deposit of any shares or securities for the collection of any dividend or interest payable with a bank
b. Deposit, transfer or holding shares or securities in the name of the State Bank of India (SBI) or a scheduled bank
c. Deposit or transfer of any shares or securities by way of security for the repayment of any loan advanced to the company or the performance of any obligation undertaken by it
d. Holding investments in the name of a depository when such investments are in the form of securities held by a company as a beneficial owner.

Additionally, companies are required to maintain a register in Form MBP 3 containing particulars of investments in shares or securities beneficially held by the company but not held in its own name along with the reasons for not holding them in its own name and the relationship or contract under which such investments are held in the name of any other person.

e. Special resolution or ordinary resolution: In certain cases, companies while making an investment would need to get necessary approvals by way of special resolution. (Refer ‘transactions requiring approval by a special resolution’ section below.)

f. Maintenance of register: A register (either manually or in electronic mode) in Form MBP 2 containing particulars of loans and guarantees given, securities provided and acquisitions made is required to be maintained by every company giving loan/guarantee or providing security or making any acquisition.

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Transactions requiring approval by a special resolution

While making investments, a company is not allowed to enter into certain transactions if the amount involved in the transaction exceeds 60 per cent of paid-up share capital, free reserves and securities premium account or 100 per cent of its free reserves and securities premium account, whichever is more, except by way of a special resolution passed at a general meeting. The special resolution would be required for following types of transactions:

a. Giving loans to any person/body corporate
b. Giving guarantee or providing security in connection with the loan taken by person/body corporate
c. Acquisition by way of subscription, purchase or securities of any body corporate.

Additionally, companies are required to disclose the following in their financial statements:

- Full particulars of the loans given
- Investments made
- Guarantee given
- Security provided
- Purpose for which such amounts have been proposed to be utilised by the recipient.

However, the provisions of Section 186 are not applicable to the loans and/or advances made by companies to their employees (other than MD or WTD which are governed by Section 185) subject to the condition that such loans/advances have been given in accordance with the conditions of service applicable to the employees and are commensurate with the remuneration policy, in cases where such policy is required to be formulated.

Additionally, approval by way of special resolution is not required in case a holding company has:

a. Given loan/guarantee or has provided security to its wholly-owned subsidiary or a joint venture company, or
b. Acquired by way of subscription, purchase or otherwise, the securities of its wholly-owned subsidiary.

The exemption is subject to disclosure of the details of such loans/guarantee or security or acquisition in their financial statements.

Transactions exempt from the requirements of Section 186 under the Companies (Amendment) Act, 2017

The provisions of Section 186 of the 2013 Act (except restriction on layers of investment companies) do not apply to the following situations:

a. Loan/guarantee/security/investment made by a banking company or an insurance company or a housing finance company in the ordinary course of its business or by a company established with the object of and engaged in the business of financing of industrial enterprises or of providing infrastructural facilities
b. Any investment made:
   i. By an investment company
   ii. In shares allotted in pursuance of Section 62(1)(a) or in shares allotted in pursuance of rights issues made by a body corporate
   iii. In respect of investment or lending activities, by a NBFC registered under Chapter III-B of the RBI Act, 1934 and whose principal business is acquisition of securities.

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62. The special resolution should specify the total amount up to which the BoD are authorised to give such loans/guarantee, to provide such security or make such acquisition.
63. ‘Person’ does not include any individual who is in the employment of the company as per the Companies (Amendment) Act, 2017.
64. MCA general circular no. 04/2015 dated 10 March 2015.
Requirements prescribed under the Listing Regulations

Listing Regulations do not contain specific provisions on inter-corporate loans/investments or loans to directors. However, they prescribe the following requirements in relation to loans and investments by companies:

- **Review of loans by audit committee (Part C of Schedule II):** The role of the audit committee, *inter alia*, includes scrutiny of inter-corporate loans and investments.

- **Information to be placed before BoD (Part A of Schedule II):** Minimum information required to be placed before the BoD of a listed entity would, *inter alia*, include sale of investments by the entity.

- **Disclosure in annual report (Schedule V):** Annual report of every debt and equity listed entity (except listed banks) would, *inter alia*, disclose the following with respect to amounts at the year end and the maximum amount of loans/advances/investments outstanding during the year:
  - **In case of holding entity:** Loans and advances in the nature of loans to subsidiaries/associates and firms/companies in which directors are interested by name and amount.
    Additional disclosure of investments by the loanee in the shares of parent entity and subsidiary, when the entity has made a loan or advance in the nature of loan.
  - **In case of subsidiary:** Same disclosures as applicable to the parent entity in the accounts of subsidiary entity.

Consider this

- A company is not allowed to make investment through more than two layers of investment companies. However, such a provision does not restrict a company from acquiring any other company incorporated outside India if such other company has investment subsidiaries beyond two layers as per laws of such country or there are requirements under any law or rule which requires existence of such subsidiaries.

- Currently, Section 185 of the 2013 Act specifically prohibits a company from providing any loan/guarantee/security to its directors or to any other person in whom the director is interested.

  However, the Companies (Amendment) Act, 2017 allows a company to give loans/guarantee/security to any person in whom any of its director is interested when two conditions are fulfilled. One, a special resolution has been passed and two, the loan is to be utilised by the borrowing company for its principal business activities.

- A company is allowed to provide loan to MD or the WTD provided the amount has been given as a part of conditions of service given by the company to all its employees or has been given in accordance with any scheme approved by the members by a special resolution.

- A company is allowed to make loans to any person, body corporate, give guarantee or provide security in connection with the loan up to 60 per cent of the paid-up capital, free reserves and securities premium account or 100 per cent of the free reserves and securities premium account, whichever is higher, without any approval by the members of the company.

- Similarly, no approval by way of a special resolution is required in case a holding company gives loan/guarantee or provides security to its wholly-owned subsidiary company or a joint venture company or acquires by way of subscription, purchase or otherwise, the securities of its wholly-owned subsidiary.
The 2013 Act has entrusted auditors with onerous responsibilities with the view to enhance reporting transparency and better corporate governance. This chapter provides a summary of the key requirements of the 2013 Act with respect to the appointment and responsibilities of an auditor.

**Auditor appointment**

An individual or a firm would be appointed as an auditor for a five-year term at the AGM of the company. The 2013 Act read with the Companies (Audit and Auditors) Rules, 2014 provides that the following class of companies (except small companies and one person companies), cannot appoint or reappoint an individual as an auditor for more than one term of five years or an audit firm (including LLP) as an auditor for more than two consecutive terms of five years each:

a. Listed companies  

b. All unlisted public companies having paid up share capital of INR10 crore or more  

c. All private limited companies having paid up share capital of INR50 crore or more  

d. All other companies having paid up share capital below the threshold limit mentioned in (b) and (c) above, but with public borrowings from financial institutions, banks or public deposits of INR50 crore or more.

65. MCA notification dated 22 June 2017
There is a cooling off period of five years for both individual auditors and audit firm within which an auditor/audit firm cannot be reappointed. Audit firms with a common partner(s) with the outgoing audit firm or operating under the same trademark or brand will also not be eligible for appointment till the cooling off period of the outgoing firm has expired.

Removal of an auditor

An auditor could be removed before expiry of his/her term by passing a special resolution and after obtaining prior approval of the CG in the manner prescribed.

Disqualification of an auditor

The 2013 Act specifically prohibits a person from appointment as an auditor if he/she, inter alia:

- Holds any security of or interest in the company or its subsidiary/holding company/associate company/fellow subsidiary
- Is indebted to the company in excess of INR5 lakh along with his/her relative
- Has a relative as a director or in the employment of the company as a director or KMP or
- Is in full-time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20 companies (except one person companies, dormant companies, small companies and private companies having paid-up share capital less than INR100 crore, in case of private companies)66.

Reporting on adequacy and effectiveness of IFC

The ICAI has issued a Guidance Note on Audit of Internal Financial Controls (GN on IFC) in September 2015 which reiterated that IFC in the context of the responsibility of the auditor for reporting on such controls implies and relates to IFC on Financial Reporting (IFC on FR). Such a reporting (on adequacy and effectiveness of IFC) would be as at the balance sheet date.

Since the audit of IFC is in connection with the financial reporting, the GN on IFC specified that the concept of materiality would be applicable even in such audits. It also prescribes certain audit procedures to be followed by an auditor while planning, performing and reporting in audit of IFC and also by companies for self-evaluation.

Further, in case of components included in the CFS of the parent company, reporting on the adequacy and operating effectiveness of IFC on FR would apply with respect to its Indian components. However, reporting on IFC does not apply with respect to interim financial statements, unless such reporting is required under any other law or regulation.

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It is important to note that an auditor of a private company is not required to report on the adequacy and operating effectiveness of IFC in the auditor’s report provided such a private company meets either of the given conditions:

a. It is a one person company or a small company, or

b. It has a turnover of less than INR50 crore as per the latest audited financial statements and the borrowings of such a company from banks or financial institutions or any body corporate at any point of time during the FY is less than INR25 crore.

The exemption from reporting on IFC has been made applicable for auditor’s reports in respect of financial statements pertaining to FYs commencing on or after 1 April 2016 that are made on or after 13 June 2017.

**Reporting with respect to financial statements only**

An auditor of a company is, *inter alia*, required to state in its auditor’s report whether the company has adequate IFC *with reference to financial statements* as per the Companies (Amendment) Act, 2017.

**Reporting of frauds by auditors**

In case an auditor, in the course of the performance of his/her duties as a statutory auditor, has reason to believe that an offence of fraud is being or has been committed against the company by its officers or employees, then the auditor is required to report the matter in the following manner:

<table>
<thead>
<tr>
<th>Report to</th>
<th>Amount involved in fraud</th>
<th>Timing of reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td>CG</td>
<td>INR1 crore or more</td>
<td>Immediately but not later than 60 days of knowledge of fraud (including period of reply/observation from Audit Committee/board).</td>
</tr>
<tr>
<td>Audit Committee/ board of company*</td>
<td>Less than INR1 crore</td>
<td>Immediately but not later than two days of knowledge of fraud.</td>
</tr>
</tbody>
</table>

(Source: KPMG in India’s analysis, 2018 based on Rule 13 of the Companies (Audit and Auditors) Rules, 2014)

*Details of such frauds to be disclosed in the board’s report in the prescribed manner.

The ICAI has issued a revised Guidance Note on Reporting on Fraud under the Section 143(12) of the 2013 Act in February 2016 which reiterates that the primary responsibility to establish adequate internal control systems to prevent and detect frauds and errors is that of the management of the company.
Consider this

- Companies are not required to get the appointment/continuance of an auditor ratified by the shareholders on an annual basis once the auditors have been appointed for five years as per the Companies (Amendment) Act, 2017.

- Any person who provides directly or indirectly any service as given in Section 144 of the 2013 Act to the company, its holding company or to its subsidiary is ineligible to be appointed as an auditor of the company.

- An auditor is required to report on IFC with regard to financial statements.

- An auditor of a holding company would have a right of access to the records of all its associates in addition to its subsidiaries for the purpose of consolidation of its financial statements with that of its subsidiaries and associates.
Mergers and acquisitions are the common forms of restructuring and ways to expand undertaken by the companies. The objectives of such arrangements could vary from drawing synergies, enhancing capacities, tax benefits to consolidation of operations, etc.

In India, mergers and acquisitions schemes are required to be approved by the National Company Law Tribunal (NCLT) under the provisions of the 2013 Act.

The 2013 Act prescribes separate procedures for following kinds of arrangements:

- Compromise or arrangement between a company and its creditors or shareholders (Section 230)
- Merger or amalgamation between companies (other than wholly-owned subsidiary and small companies) (Section 232)
- Merger or amalgamation of a company with wholly-owned subsidiary or small companies (Section 233) and
- Merger or amalgamation of a company with a foreign company (Section 234).

The Rules facilitating the provisions of the above sections i.e. Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 (Compromises Rules) came into effect from 15 December 2016.

This chapter provides an overview of the key provisions of the 2013 Act and the related Rules in relation to the restructuring of companies (i.e. compromises, arrangements and amalgamations) and related requirements of the Listing Regulations that are applicable to listed companies in India.
Arrangements with creditors or shareholders (Section 230 and Section 232)

A company undertaking a scheme of arrangement is governed by the provisions of Section 230 and 232 of the 2013 Act. A company can restructure its arrangements with creditors or shareholders in a number of ways:

a. Reorganisation of the company’s share capital by the consolidation of shares of different classes or by the division of shares into shares of different classes, or by both of those methods
b. Reduction of share capital
c. Corporate debt restructuring67 (consented by not less than 75 per cent of the secured creditors)
d. Buy-back of securities
e. Take-over offer68
f. Merger69/amalgamation of any two or more companies
g. Demerger/division70 of companies.

A company that undertakes any of the above mentioned schemes of arrangement would need to comply with certain procedure. The procedure is as follows:

• Application to the NCLT: An application to the NCLT can be made for the proposed scheme of compromise/arrangement in Form No. NCLT-1. This application can be made by the company, any creditor or member of the company or by the liquidator (in case of a company being wound up). The above application should be accompanied by appropriate disclosures (by way of an affidavit in Form No. NCLT-6) and also include:
   a. All material facts relating to the company such as the latest financial position of the company, the latest auditor’s report on the accounts of the company and the pendency of any investigation or proceedings against the company
   b. Reduction of share capital, if any, included in the compromise or arrangement.

In case of a corporate debt restructuring scheme, a company would have to disclose to the NCLT:

a. A creditor’s responsibility statement in Form No. CAA.1
b. An auditor’s report stating that the fund requirements of the company after the corporate debt restructuring (as approved by NCLT) conform to the liquidity test based upon the estimates provided to them by the BoD
c. Safeguards for the protection of other secured and unsecured creditors
d. Where the company proposes to adopt the corporate debt restructuring guidelines specified by the RBI, a statement to that effect
e. A valuation report in respect of the shares and the property and all assets, tangible and intangible, movable and immovable, of the company by a registered valuer.

• Order and notice of the meeting: On receipt of the application, the NCLT could order a meeting of the shareholders/creditors to be held in the prescribed manner.

• Notice to statutory authorities: A notice in Form No. CAA.3 along with the prescribed documents should be given to the CG, income-tax authorities, RBI, SEBI, ROC, stock exchanges, official liquidator, Competition Commission of India (CCI) and other sectoral regulators/authorities which are likely to be affected by the compromise or arrangement.

A period of 30 days has been provided to the above mentioned authorities to make a representation on the proposed scheme and if no such response is received, it would be presumed that they have no representations.

This notice is not required in case of merger/amalgamation between parent and its wholly-owned subsidiary or two or more small companies.

67. Scheme that restructures or varies the debt obligations of a company towards its creditors.
68. Related provisions have not been notified yet.
69. Merger includes merger by absorption or merger by formation of a new company.
   a. Merger by absorption: Where the undertaking, property and liabilities of one or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to another existing company, it is a merger by absorption.
   b. Merger by formation of a new company: Where the undertaking, property and liabilities of two or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to a new company, whether or not a public company, it is a merger by formation of a new company.
70. Where the undertaking, property and liabilities of the company in respect of which the compromise or arrangement is proposed are to be divided among and transferred to two or more companies each of which is either an existing company or a new company, such a scheme involves division.
• **Scheme exempted from meeting:** In case a scheme of compromise/arrangement has been approved by the creditors/class of creditors with at least 90 per cent value, NCLT could dispense with calling of a meeting of such creditors/class of creditors.

• **Voting on the scheme:** Person in receipt of notice may vote on the proposed scheme either in person, through proxies or through electronic means within one month from the date of receipt of notice.

• **Objection to the scheme:** An arrangement can be objected only by a person holding at least 10 per cent shareholding or owing 5 per cent debt as per the latest audited financial statements.

• **Auditor’s certificate on compliance with AS:** A scheme would not be sanctioned unless an auditor’s certificate to the effect that the accounting treatment specified in the scheme is in conformity with the prescribed AS has been filed with the NCLT.

• **Order of the scheme:** A scheme of compromise or arrangement approved by creditors/members representing three-fourths in value and sanctioned by the NCLT (by an order) would be binding on the company, its creditors/members, its contributories and on the liquidator (in case of winding up).

• **Order of the NCLT:** An order of the NCLT approving the scheme shall, inter alia, provide an option to preference shareholders to obtain arrears of dividend in cash or accept equity shares equal to the value of the dividend payable, in case of scheme involving conversion of preference shares into equity shares and exit offer to dissenting shareholders.

  Such an order should be filed with the ROC within 30 days of the receipt of the order by the company.

• **Shares in own name:** Shares should not be held by the transferee company in its own name or in the name of any trust. Any such shares, if held should be cancelled or extinguished.

• **Amalgamation between listed and unlisted companies:** In case of amalgamation of a listed transferor company into an unlisted transferee company, unlisted transferee company should remain unlisted (unless it becomes listed) and should provide for payment of value of shares held by dissenting shareholders.

• **Order of winding up:** The NCLT has the power to supervise the implementation of the approved compromise or arrangement and if it is satisfied that the scheme could not be implemented with/without modification and the company is unable to pay its debts as per the scheme, then it could order winding up of such a company.

• **Appointed date:** In case of merger/amalgamation between companies, the scheme should indicate an appointed date from which the scheme would be deemed to be effective.

It is important to note that as per the requirements of Ind AS 103, *Business Combinations*, an acquirer needs to identify the acquisition date which is the date on which it obtains control of the acquiree. Such a date is generally the closing date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree.

However, an acquirer could obtain control on a date earlier or later than the closing date (e.g. a written agreement provides that the acquirer obtains control of the acquiree on a date before closing date).

The ITFG in its clarifications’ bulletin 12, *inter alia*, considered a situation where pursuant to a court scheme, a company gets merged with another company with an appointed date approved by the NCLT (as 1 April 2016) and the companies would prepare their first Ind AS financial statements for the year ending 31 March 2018.

In the above situation, ITFG clarified that if the NCLT approves the scheme with a different appointed date as compared to the acquisition date as per Ind AS 103, then the appointed date approved by the NCLT would be considered as the acquisition date for business combinations. The company would be required to provide appropriate disclosures and the auditor would need to consider the requirements of relevant AS.

This would be applicable both for, business combinations under common control as well as business combinations not under common control.

• **Yearly statement of compliance:** A statement (in Form No. CAA.8) confirming implementation of the scheme in accordance with the order to be submitted with the ROC within 120 days from the end of each FY until the completion of the scheme, in case of merger/amalgamation between companies.

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Merger or amalgamation of a company with a wholly-owned subsidiary or small companies (Section 233)

The 2013 Act provides a simplified procedure for merger and amalgamation between:

- Holding company and its wholly-owned subsidiary
- Two or more ‘small companies’ or
- Such other prescribed class of companies.

Any such merger could be given effect to without the approval of the NCLT, subject to compliance with other specified procedures which, \textit{inter alia}, include the following:

a. Filing of a declaration of solvency with the ROC by each of the companies involved in the merger/amalgamation in Form No. CAA.10

b. Approval of scheme by members holding at least 90 per cent of the total number of shares and by majority representing nine-tenth in value of the creditors of respective companies.

Merger or amalgamation of a company with a foreign company (Section 234)

A foreign company incorporated outside India could merge with an Indian company or a company could merge with a foreign company (incorporated in the specified jurisdictions) subject to the following:

- Prior approval of the RBI
- Ensure compliance with the above mentioned provisions of Sections 230 to 232 of the 2013 Act and the related Rules

- Transferee company should ensure that valuation is conducted by a registered valuer and is in accordance with internationally accepted principles on accounting and valuation. A declaration to this effect would be required to be attached with the application made to RBI for obtaining its approval.

Additionally, the terms and conditions of the scheme of merger may provide, among other things, for the payment of consideration to the shareholders of the merging company in cash, or in depository receipts, or partly in cash and partly in depository receipts, as the case may be, as per the scheme to be drawn up for the purpose.

The concerned company should file an application with the NCLT for approval of the merger after complying with the above mentioned conditions.

Purchase of minority shareholding (Section 236)

The 2013 Act has introduced new provisions relating to buy-out of minority shareholding.

According to it, any person or group of persons holding 90 per cent of the issued equity share capital of a company by virtue of an amalgamation, share exchange, conversion of securities or for any other reason, can purchase the remaining equity shares of the company from minority shareholders at a price determined by a registered valuer in accordance with the prescribed rules.

Similarly, the minority shareholders of the company may also offer the majority shareholders to purchase the minority equity shareholding of the company.

72. Small company means:
   a. A non-public company
   b. Not being a holding/subsidiary company, a company for charitable purposes or a company established under a special Act
   c. Having a paid-up share capital less than INR50 lakh (amount can be prescribed up to INR5 crore) and turnover less than INR2 crore (amount can be prescribed up to INR20 crore).

73. Effective from 13 April 2017.

74. Foreign company means any company or body corporate incorporated outside India whether having a place of business in India or not.

75. Company incorporated under the 2013 Act or under any previous company law.
Requirements prescribed under the Listing Regulations

The Listing Regulations prescribe following in relation to the schemes of arrangements undertaken by a listed entity:

- **Filing of draft scheme of arrangement with the stock exchange (Regulation 37):** A listed entity that desires to undertake a scheme of arrangement (including with an unlisted entity) under the requirements of the 2013 Act is required to obtain a no objection letter or an observation letter from the stock exchange. A scheme of arrangement cannot be filed with the court or NCLT unless the listed entity has obtained an observation/no-objection letter from the stock exchange.

  Further, the validity of the observation/no-objection letter should be six months from the date of issuance within which the draft scheme should be submitted to the court/NCLT for approval.

  The schemes of arrangement for merger of a wholly-owned subsidiary or its division[^76] with the parent entity would not be required to be filed with SEBI (under the Listing Regulations). Such schemes should be filed with the stock exchanges for the purpose of disclosure.

- **Conditions for undertaking scheme of arrangement:** SEBI, through its various circulars[^77], has laid down detailed requirements to be complied with by listed entities while undertaking schemes of arrangements. Some of the key requirements are as follows:
  - **Submission of documents:** A listed entity is mandatorily required to submit certain documents with the stock exchange. These, *inter alia*, includes valuation report by an independent CA and fairness opinion by an independent[^78] SEBI registered merchant banker on valuation of assets/shares done by the valuer for the listed entity and unlisted entity.
  - **Conditions for scheme of arrangement with unlisted entities:** These, *inter alia*, require that the percentage of shareholding of pre-scheme public shareholders of the listed entity and the Qualified Institutional Buyers (QIBs) of the unlisted entity, in the post scheme shareholding pattern of the merged entity on a fully diluted basis[^79] should not be less than 25 per cent.
  - **Lock-in requirements for a scheme for hiving-off of a division from a listed entity to an unlisted entity:** In case of a scheme involving merger of a listed company or its division[^80] into an unlisted entity, the entire pre-scheme share capital of the unlisted issuer seeking listing should be locked-in as follows:
    a. Shares held by promoters up to the extent of 20 per cent of the post-merger paid-up capital of the unlisted issuer, should be locked-in for a period of three years from the date of listing of the shares of the unlisted issuer.
    b. The remaining shares should be locked-in for a period of one year from the date of listing of the shares of the unlisted issuer.
    c. No additional lock-in should be applicable if the post scheme shareholding pattern of the unlisted entity is exactly similar to the shareholding pattern of the listed entity.

  The shares locked-in under this clause can be pledged with any scheduled commercial bank or public financial institution as collateral security for loan granted by such bank or institution if pledge of shares is one of the terms of sanction of the loan[^81].

[^76]: Applicable with effect from 3 January 2018.


[^78]: Applicable with effect from 3 January 2018.

[^79]: Applicable with effect from 3 January 2018.

[^80]: Applicable with effect from 3 January 2018.

[^81]: Applicable with effect from 3 January 2018.
- **Approval of shareholders to a scheme of arrangement:** Voting for approval of the scheme will be only through e-voting.

  Additionally, in certain cases, SEBI has mandated that a scheme of arrangement would be approved only if the votes cast by the public shareholders in favour of the proposal are more than the number of votes cast by the public shareholders against it. These, *inter alia,* includes schemes where parent listed entity has acquired equity shares of the subsidiary from shareholders of subsidiary and the subsidiary is being merged with the parent listed entity.

- **Time period for completion of formalities for listing of specified securities:** It should be ensured that the steps for listing of specified securities are completed and trading in securities should commence *within 60 days*82 of receiving the order of the HC/NCLT simultaneously on all the stock exchanges where the equity shares of the listed entity (or transferor entity) are/were listed.

  • **Requirements of stock exchanges to supersede the scheme (Regulation 11):** A listed entity is required to ensure that any scheme of arrangement/amalgamation/merger/reconstruction/reduction of capital, etc. presented to any court or NCLT should not violate, override or limit the provisions of securities law or requirements of the stock exchange.

    Such a provision is not applicable to the units issued by the listed mutual funds.

  • **Disclosures (Regulation 30 read with Part A of Schedule III):** Every listed entity is required to disclose the scheme of arrangement (amalgamation/merger/demerger/restructuring) or any other restructuring to the stock exchange without application of the guidelines for materiality as such events are considered as deemed to be material.

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**Consider this**

- No scheme of arrangement would be sanctioned unless an auditor’s certificate to the effect that the accounting treatment specified in the scheme is in conformity with the prescribed AS has been filed with the NCLT.

  However, such certificate is not required in case of merger/amalgamation between parent and its wholly-owned subsidiary or two or more small companies. Approval of NCLT is also not required in such cases.

- Appointed date approved by the NCLT would be considered as the acquisition date for business combinations under Ind AS, in case NCLT approves an appointed date different from acquisition date.

- All listed entities are required to obtain observation/no-objection letter from stock exchange on the proposed scheme of arrangement before filing such scheme with the court/NCLT for approval. Guidelines issued by SEBI need to be adhered while undertaking the schemes of arrangements.

  Additionally, all schemes of arrangements should be disclosed to the stock exchanges as they are deemed to be material events/information under the Listing Regulations.

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82. Applicable with effect from 3 January 2018.
In the past, MCA vide Section 462(1) of the 2013 Act issued two notifications dated 5 June 2015 and 13 June 2017 and provided various exceptions/modifications/adaptations to the provisions of the 2013 Act for private companies.

Overview of the exceptions/modifications/adaptations to the 2013 Act

The relaxations provided to private companies have been categorised under the given heads:

- Sections/sub-sections that are amended for private companies
- Sections/sub-sections that would not apply to any private company
- Sections/sub-sections that would not apply to certain class of private companies.

Sections/sub-sections that are amended for private companies

The following sections/sub-sections of the 2013 Act have been amended for the private companies:

- **Definition of financial statements (Section 2(40)):**
  Financial statements, in relation to a company, include:
  a. A balance sheet as at the end of the FY
  b. A statement of profit and loss, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the FY
  c. Cash flow statement for the FY
  d. A statement of changes in equity, if applicable and
  e. Any explanatory note annexed to, or forming part of, any document referred to in (a) to (d) above.
However, financial statements of a one person company, small company, dormant company and a private company which is a start-up company are not required to include a cash flow statement. The exemption became effective from 13 June 2017.

- **Further issue of share capital:** Section 62(1)(a)(ii) of the 2013 Act provides a time limit for rights’ offer that is ‘not less than 15 days and not exceeding 30 days’ from the date of offer. It further states that offer not accepted within the specified time period would be deemed to have been declined. Additionally, Section 62(2) requires an entity to dispatch the notice of such an offer at least three days before the opening of the issue.

However, in case a private company wants to reduce the time period for the rights issue to less than the period prescribed in Section 62(1)(a)(ii) and Section 62(2), it can do so provided 90 per cent of its members have given their consent in writing or via an electronic mode.

Section 62(1)(b) deals with a situation when a company proposes to increase its subscribed capital by the issue of further shares, and the shares are offered to employees under a scheme of employees’ stock option. Such an offer is subject to the specified conditions which, inter alia, require a special resolution by the company. However, for private companies, passing of an ordinary resolution would be sufficient as per the amendment to the 2013 Act.

These exemptions became effective from 5 June 2015.

It is important to note that in the erstwhile 1956 Act, the above provisions were not applicable to private companies (including a private company which is a subsidiary of a public company) i.e. private companies were allowed to offer its further issue of capital to any person and in any manner as they deemed fit.

- **Annual return:** Every company is required to prepare an annual return in the prescribed form and contain the particulars as they stood on the close of the FY. Private companies which are small companies are required to provide details of aggregate amount of remuneration drawn by directors instead of providing details of remuneration of directors and KMP of the company.

Additionally, the annual return of a private company which is a start-up is required to be signed by the company secretary, or where there is no company secretary, by the director of the company. (Section 92)

These amendments became effective from 13 June 2017.

- **Mandatory rotation of auditors:** Section 139(2) of the 2013 Act read with Rule 5 of the Companies (Audit and Auditors) Rules, 2014 provides that certain class of companies cannot appoint or reappoint an individual as an auditor for more than one term of five years or an audit firm as an auditor for more than two consecutive terms of five years each. Those class of companies are as follows:

  a. Listed companies
  b. All unlisted public companies with paid-up share capital of INR10 crore or more
  c. All private limited companies with paid-up share capital of INR50 crore (earlier INR20 crore) or more
  d. All companies with paid-up share capital of below threshold limit mentioned in (b) and (c) above, but with public borrowings from financial institutions, banks or public deposits of INR50 crore or more.

The mandatory rotation of auditors’ requirement is not applicable to small companies and one person companies.

The MCA issued a notification amending the limit for mandatory auditor rotation for all private companies. Now private companies with paid-up share capital of INR50 crore or more required to follow the mandatory rotation of auditors. This notification became effective from 22 June 2017.

The CLC in its report highlighted that the threshold for private companies for rotation of auditors has been prescribed for the purposes of good corporate governance and larger public interest. Accordingly, the CLC did not propose to increase the threshold of auditor rotation for private companies in its report. However, MCA has still amended the threshold.
• **Eligibility/qualifications/disqualifications of auditors:** Section 141(3)(g) specifically prohibits a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as an auditor of more than 20 companies, from being appointed as an auditor.

  The MCA provided relaxation while calculating the limit of 20 companies and following companies would be excluded:
  
  - One person company
  - Dormant companies
  - Small companies and
  - Private companies having paid-up share capital less than INR100 crores.

  The above relaxation became applicable from 5 June 2015.

  The 1956 Act, on the other hand, specifically excluded all private companies from the ceiling of number of audits to be conducted by an auditor i.e. an auditor/audit firm was allowed to conduct audit of any number of private companies under the 1956 Act.

• **Meetings of board:** Every company is required to hold first meeting of its BoD within 30 days of the date of its incorporation and thereafter required to hold a minimum number of four board meetings every year in such a manner that not more than 120 days should intervene between two consecutive board meetings.

  However, in case of a one person company, small company, dormant company and a private company which is a start-up, a relaxation has been given. They need to hold at least one board meeting in each half of a calendar year and the gap between two meetings should not be more than 90 days. (Section 173(5))

  The provision became applicable from 13 June 2017.

• **Quorum for meetings of board:** The quorum for a board meeting of a company should be higher of the following limits:
  
  - One-third of the total strength of the board or
  - Two directors.

  However, where at any time the number of interested directors exceeds or becomes equal to two-thirds of the total strength of the board, the number of directors who are not interested directors and present at the meeting, being not less than two, would be the quorum during such time. (Section 174(3))

  In case of private companies, interested directors can also be counted towards quorum in such a meeting after disclosure of his/her interest in accordance with Section 184 of the 2013 Act. This relaxation is in line with the recommendation of the CLC and is applicable from 13 June 2017.

  Additionally, the interested director of a private company can also participate in the board meeting in which the contract or arrangement (in which he/she has direct/indirect interest) is being discussed after disclosure of his/her interest. These relaxations came into force on 5 June 2015.

**Sections/sub-sections that would not apply to any private company**

• **RPTs:** Section 2(76)(viii) of the 2013 Act provides a definition of a ‘related party’ and Section 188 requires that specified transactions with related parties that are not in the ordinary course of business and which are not at an arm’s length would require consent of the BoD of the company.

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**Exemption for private companies**

The Companies (Amendment) Act, 2017 has amended the definition of related party (as given in Section 2(76)(viii)). According to it, any body corporate which is a:

  a. Holding, subsidiary or an associate company of such company
  b. Subsidiary of a holding company to which it is also a subsidiary or
  c. An investing company or the venturer of the company

is a related party.

The Companies (Amendment) Act, 2017 provides relief to private companies. The above defined Section 2(76)(viii) does not apply to private companies. Therefore, in case of private companies, the above mentioned class of body corporates would not be considered as related parties.

Further, second proviso to Section 188(1) requires a related party (who is a member) to abstain from voting on a resolution of a company to approve a contract/arrangement entered into by the company. However, this proviso is not applicable to a private company i.e. in the case of a private company, members who are related parties are also allowed to vote. These amendments are applicable from 5 June 2015.
• Resolutions and agreements to be filed: Section 117 pertains to resolutions and agreements to be filed with the ROC. Section 117(3)(g) states that resolutions passed in pursuance of Section 179(3) (powers of board) should follow the requirements of Section 117. Private companies are not required to file with the ROC resolutions passed by the board which are covered in Section 179(3) of the 2013 Act. Following are the resolutions that are not required to be filed:
  a. To make calls on shareholders in respect of money unpaid on their shares
  b. To authorise buy-back of securities under Section 68
  c. To issue securities, including debentures, whether in or outside India
  d. To borrow monies
  e. To invest the funds of the company
  f. To grant loans or give guarantee or provide security in respect of loans
  g. To approve financial statements and the board’s report
  h. To diversify the business of the company
  i. To approve amalgamation, merger or reconstruction
  j. To take over a company or acquire a controlling or substantial stake in another company,
  k. Any other matter which may be prescribed.

The amendment came into effect from 5 June 2015.

• Rights of persons other than retiring directors to stand for directorship: Section 160 relates to right of persons other than retiring directors (i.e. not liable to retire by rotation) to stand for directorship. This Section is not applicable to private companies with effect from 5 June 2015.

The above provision was not applicable to private companies (not being a subsidiary of public company) under the 1956 Act as well.

• Appointment of directors to be voted individually: Section 162 deals with the manner of appointing two or more persons as directors of a company by a single resolution. This section is not applicable to private companies with effect from 5 June 2015.

• Restriction on powers of board: Section 180 that deals with the restrictions on the powers of the board is not applicable to the private companies with effect from 5 June 2015.

• Appointment and remuneration of managerial personnel: Section 196(4), *inter alia*, states that subject to the provisions of Section 197 and Schedule V to the 2013 Act (relating to managerial remuneration), a MD, WTD or manager should be appointed by a company. The terms and conditions of such appointment and remuneration payable should be approved by the BoD at a meeting and would be subject to approval by a resolution at the next general meeting of the company. The CG approval would also be required in case such appointment is at variance to the conditions specified in Part I of Schedule V to the 2013 Act. Additionally, a return in the prescribed form should be filed with the ROC within 60 days of such an appointment.

Section 196(5) states that where an appointment of a MD, WTD or manager is not approved by the company at a general meeting, any act done by him/her before such approval should not be deemed to be invalid.

The provisions of Section 196(4) and 196(5) are not applicable to the private companies with effect from 5 June 2015.

Sections/sub-sections that would not apply to certain class of private companies

• Prohibition on acceptance of deposits from public: Clauses (a) to (e) of the Section 73(2) deal with the conditions to be fulfilled by the companies for accepting deposits from the public or from its members.

The provisions of clauses (a) to (e) of Section 73(2) of the 2013 Act would not be applicable to a private company if it meets any of the given criterion:

  a. It accepts monies from its members not exceeding 100 per cent of aggregate of the paid-up share capital, free reserves and securities premium
  b. It is a start-up company for five years from the date of its incorporation, or
  c. It fulfils all the following conditions:
     i. The private company is not an associate or a subsidiary company of any other company
     ii. The borrowings of such a company from banks or financial institutions or any body corporate is less than twice of its paid-up share capital or INR50 crore, whichever is lower and
     iii. Such a company has not defaulted in the repayment of such borrowings subsisting at the time of accepting deposits under Section 73.
Additionally, the private company would be required to file the details of monies accepted to the ROC in such a manner as may be specified.

Apart from providing relief to private companies which are start-ups to raise funds without complying with the prescribed conditions, the CLC also recommended to grant relief to the private companies which are engaged in the infrastructure sector to accept deposits from its members without any upper limit. However, no such specific exemption to private companies in the infrastructure sector has been provided under the Companies (Amendment) Act, 2017.

**IFC:** An auditor of a private company is not required to report on the adequacy and operating effectiveness of IFC in the auditor’s report (as required under Section 143(3)(i) of the 2013 Act) provided such a private company meets either of the given conditions:

- It is a one person company or a small company, or
- It has a turnover of less than INR50 crore as per the latest audited financial statements and the borrowings of such a company from banks or financial institutions or any body corporate at any point of time during the FY is less than INR25 crore.

The exemption from reporting on IFC has been made applicable for auditor’s reports in respect of financial statements pertaining to FYs commencing on or after 1 April 2016 that are made on or after 13 June 2017 (i.e. the date of notification of the amendment).

An auditor of a specified private company is not required to report on IFC, but it would be advisable that such companies should also internally evaluate their processes/systems as part of better corporate governance.

**Kinds of share capital:** Section 43 deals with the kinds of share capital namely equity and preference shares. This section will not apply to a private company if memorandum or articles of association of the private company provide that Section 43 would not apply. The amendment came into effect from 5 June 2015.

**Voting rights:** Section 47 on voting rights attached to shares would not apply to a private company if memorandum or articles of association of the private company provides that Section 47 would not apply. The amendment came into effect from 5 June 2015.

**Restrictions on purchase by company or giving of loans by it for purchase of its shares:** Section 67 provides certain restrictions on companies for buyback of its shares or to give loans for purchase of its shares. These restrictions would not apply to private companies provided following conditions have been met:

- No other body corporate has invested in its share capital
- If the borrowings of such a company from banks or financial institutions or any body corporate is less than twice its paid-up share capital or INR50 crore, whichever is lower, and
- If such a company is not in default in repayment of such borrowings subsisting at the time of making transactions under this Section.

The amendment came into effect from 5 June 2015.

**Management and administration:** Following Sections would apply to private companies unless otherwise specified in respective Sections, or unless articles of the private company otherwise provide:

- Section 101: Notice of meeting
- Section 102: Statement to be annexed to notice
- Section 103: Quorum for meetings
- Section 104: Chairman of meetings
- Section 105: Proxies
- Section 106: Restriction on voting rights
- Section 107: Voting by show of hands
- Section 109: Demand for poll.

The amendment came into effect from 5 June 2015.

**Loans to directors, etc.:** Section 185 of the 2013 deals with loans to directors and companies in which directors are interested. This section does not apply to a private company if it meets all the given conditions:

- No other body corporate has invested in its share capital
- Its borrowings from banks or financial institutions or any bodies corporate is less than twice of their paid-up share capital or INR50 crore, whichever is lower, and
- It has not defaulted in repayment of such borrowings subsisting at the time of making transactions under this section.

The amendment came into effect from 5 June 2015.

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Consider this

- Private companies form the backbone of the corporate structure prevalent in India. The relaxations from various provisions of the 2013 Act are expected to ease out the hardships faced by the private companies and would reduce the cost of compliances.
- Exemptions to private companies which are start-ups are expected to attract more investments in such companies.
- Additionally, a private company, in general, should take note of the following important points:
  - A private company could prescribe lesser time for rights issue (i.e. less than 15 days) when 90 per cent of its members have given their consent in writing or in electronic mode.
  - It could increase its subscribed share capital by offering the shares to its employees (under a scheme of employees’ stock option) by passing an ordinary resolution.
  - Mandatory auditor rotation norms are applicable to all private companies with paid-up share capital of INR50 crore or more.
  - Interested directors of private companies are allowed to be counted towards quorum in a board meeting and are allowed to participate in the board meeting in which the contract or arrangement (in which he/she has direct/indirect interest) is being discussed subject to disclosure of his/her interest.
  - Members of private companies who are related parties are also allowed to vote on a resolution of a company to approve a contract/arrangement entered into by the company.
  - Auditor of a private company (other than small company, one person company or with turnover and borrowings less than INR50 crore and INR25 crore) are mandatorily required to report on the adequacy and operating effectiveness of IFC.
  - Private companies are allowed to buy-back its own shares or could grant loans for purchase of its own shares without any restrictions. Similarly, no restriction is applicable to them while granting loans to directors and companies in which directors are interested.
SEBI relaxes norms governing schemes of arrangements by listed entities

Background
Listed entities that desire to undertake a scheme of arrangement or are involved in a scheme of arrangement need to follow the regulations laid down by the Securities and Exchange Board of India (SEBI). On 10 March 2017, SEBI issued a circular number CFD/DIL3/CIR/2017/21 which laid down a revised regulatory framework for schemes of arrangements by listed entities and relaxation under Rule 19(7) of the Securities Contract (Regulation) Rules, 1957.

New development
The SEBI received representations to improve the existing framework governing schemes of arrangements. Additionally, SEBI wanted to expedite the processing of draft schemes and prevent misuse of schemes to bypass regulatory requirements. Therefore, on 3 January 2018, SEBI issued a circular number CFD/DIL3/CIR/2018/2 to make certain amendments to the circular dated 10 March 2017.

The recent circular is applicable from the date of its issue i.e. 3 January 2018. Some of the key relaxations provided in the circular relate to the following topics:

- Submission of documents to stock exchanges
- Relaxations with respect to locked-in promoter’s shares
- Extended time period for listing of specified securities.

Please refer to KPMG in India’s First Notes dated 18 January 2018, which provided an overview of the key amendments/relaxations given in the circular.

SEBI Board Meeting

The SEBI in its meeting held on 28 December 2017 has taken certain important decisions. The key decisions, inter alia, include the following.

Amendments to SEBI (Listing Obligations and Disclosure Requirements), 2015: The SEBI has approved the following amendments

- Disclosure of financial results on the exchange(s) by issuers of listed debt in line with the corresponding requirements for issuers of listed equity: Issuers of listed debt should disclose on the exchange(s) the below mentioned financial results in the format as prescribed in Schedule III to the Companies Act, 2013 (excluding notes and detailed sub-classification):
  - Statement of Profit and Loss on a quarterly and year-to-date basis
  - Statement of Assets and Liabilities/ Balance Sheet on a half-yearly basis

The above specified financial results should be submitted by the issuer within 45 days of end of the first three quarters and 60 days of end of the last quarter.

- Disclosure of annual consolidated financial results to the exchange(s) in case of issuers having only listed debt: Issuers of listed debt should disclose their audited annual consolidated financial results on the exchange(s) within 60 days from the end of the financial year.

Additional methods for listed entities to achieve Minimum Public Shareholding (MPS) requirements

Rule 19A of the Securities Contracts (Regulations) Rules, 1957 (SCRR) provides that every listed company is required to maintain a public shareholding of at least 25 per cent. In this regard, listed public sector companies have been provided additional time till 21 August 2018 to comply with the requirements. Accordingly, listed entities that have a public shareholding of less than 25 per cent are required to comply with the MPS requirements. The public shareholding can be increased by following any of methods mentioned below:

- Issuance of shares to public through prospectus,
- Offer for sale to public through prospectus,
- Sale of shares held by promoters through secondary market in terms of SEBI circular CIR/MRD/DP/05/2012 dated 1 February 2012,
- Institutional placement programme,
- Rights issue to public shareholders,
- Bonus shares to public shareholders, and
- Any other method as may be approved by SEBI under case to case basis.

In its recent board meeting, SEBI has decided to introduce two additional methods for listed entities to comply with the MPS requirement i.e. Qualified Institutions Placement (QIP) and sale of shares up to 2 per cent held by promoters/promoter group in open market subject to certain conditions. The SEBI has also approved necessary amendments to SEBI (Issue of Capital and Disclosure Requirements (ICDR)) Regulations, 2009.

(Source: SEBI press release PR No.: 68/2017 dated 28 December 2017)

MCA issued Condonation of Delay Scheme, 2018

Background

Section 137 of the Companies Act, 2013 (2013 Act) requires every company to file a copy of financial statements to the Registrar of Companies (RoC) within 30 days of the date of annual general meeting in the prescribed manner. Further, Section 92 of the 2013 Act requires every company to file a copy of the annual return to RoC, within 60 days from the date of annual general meeting.

In case the company fails to file its financial statements and annual return within the stipulated time, then such a company in default would be punishable with fine and imprisonment as specified in the 2013 Act.

Further, Section 164 of the 2013 Act provides for disqualification of a director on account of default by a company in filing an annual return or a financial statement for a continuous period of three years.

New development

The MCA, through its circular dated 29 December 2017 has introduced Condonation of Delay Scheme 2018 (the scheme). The scheme aims to give an opportunity to companies in default to rectify the defaults. The scheme is applicable to companies in default that have not filed their financial statements or annual returns as required under the Companies Act, 1956 (1956 Act) or 2013 Act, as the case may be, and the Rules made thereunder for a continuous period of three years (other than the companies which have been struck off/ whose names have been removed from the register of companies under Section 248(5) of the 2013 Act).

At the conclusion of the scheme, RoC will take all necessary actions under the 1956 Act/2013 Act against the companies who have not availed of this scheme and continue to be in default in filing the overdue documents. The scheme came into force with effect from 1 January 2018 and will remain in force upto 31 March 2018.

(Source: MCA circular no. 16/2017 dated 29 December 2017)
Ind AS Transition Facilitation Group (ITFG) issued clarifications bulletin 13

The ITFG in its meeting considered certain issues received from the members of the Institute of Chartered Accountants of India (ICAI) and issued its clarifications bulletin 13 dated 16 January 2018 to provide clarifications on 10 issues in relation to the application of Ind AS.

The ITFG provided clarification on the following issues relating to the application of Ind AS:

- Capitalisation of Dividend Distribution Tax (DDT) as borrowing costs
- Accounting treatment for DDT in consolidated financial statements in case of partly-owned subsidiary
- Accounting for a financial guarantee received by a company from its director
- Disclosure of major customers in case of single operating segment
- Applicability of Non-Banking financial Companies (NBFC) road map to a company performing role of NBFC
- Disclosure of operating profit on the face of statement of profit and loss
- Timing of recognition of renegotiation gain/loss
- Accounting for partial disposal of an investment in a subsidiary
- Disclosure of foreign currency risk
- Computation of financial liability in a compound financial instrument.

(Source: ITFG’s Clarification Bulletin 13 issued by ICAI)

Exposure drafts issued by ICAI

The ICAI recently issued exposure drafts to the following Ind AS:

Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance: The exposure draft proposes amendments to the following heads:

- Accounting for non-monetary government grants
- Presentation of grants related to assets:
- Repayment of government grants
- Transitional provisions.

The amendments focus on closing the gap with reference to IFRS. This ED aligns Ind AS 20 to IAS 20.

Effective date: The amendments to Ind AS 20 have been proposed to be made effective for annual periods beginning on or after 1 April 2018 subject to notification by MCA.

Please refer to KPMG in India’s IFRS Note dated 12 January 2018, which provides an overview of the amendments proposed to Ind AS 20

Appendix C, Uncertainty over income tax treatments to Ind AS 12, Income Taxes: The Accounting Standards Board (ASB) of ICAI issued an exposure draft to Appendix C, Uncertainty over Income Tax Treatments of Ind AS 12 which seeks to bring clarity to the accounting for income tax treatments that have yet to be accepted by tax authorities. The requirements of proposed Appendix C to Ind AS 12 are in line with the requirements of IFRIC 23, Uncertainty over Income Tax Treatments issued by the Interpretations Committee of the International Accounting Standards Board (IASB).

Effective date: The appendix is proposed to be applicable for annual periods beginning on or after 1 April 2019. Early application is permitted.

Comments on the exposure draft may be submitted up to 19 February 2018.

Please refer to KPMG in India’s IFRS Note on IFRIC 23 - IFRIC 23 clarifies the accounting treatment for uncertain income tax treatments dated 13 June 2017, which provides an overview of IFRIC 23.

(Source: Exposure draft on Ind AS 20 ED/Ind AS/2018/01 dated 5 January 2018 and Exposure draft on Ind AS 12 ED/ Ind AS/2018/02 dated 29 January 2018 issued by ICAI)
Equity listed entities

The SEBI has provided following relaxations to equity listed entities for the first year of Ind AS implementation (and for subsequent phases up to FY2019-20)86:

• **Timelines for submitting quarterly financial results:** The timelines for submitting the financial results of the first two quarters of the equity listed entities have been extended by one month. Accordingly, for the quarter ending 30 June and 30 September, the quarterly results may be submitted up to 14 September and 14 December respectively.

It is to be noted that no extension in the timelines for submission of the financial results for the quarter ending December and March have been provided. Accordingly, these are required to be filed up to 14 February and 30 May respectively.

• **Formats for disclosure of financial results:** The formats for unaudited/audited quarterly financial results i.e. statement of profit and loss and the unaudited/audited half-yearly balance sheet to be submitted by the listed entities with the stock exchanges, should be as per the formats for balance sheet and statement of profit and loss (excluding notes and detailed sub-classification) as prescribed in Schedule III to the 2013 Act. However, banking and insurance companies should follow the formats as prescribed under the respective Acts/Regulations as specified by their regulators.

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86. SEBI circular no. CIR/CFD/FAC/02/2016 dated 5 July 2016.
• **Ind AS compliant comparatives:** Following have been prescribed with respect to submission of Ind AS compliant comparatives:

*For the quarter ending 30 June and 30 September*

Equity listed entities are required to provide Ind AS compliant financial results for the corresponding first two quarters (i.e. 30 June and 30 September). However, audit or limited review of the comparatives is not mandatory.

Further, for the quarter ending 30 June, submission of Ind AS compliant financial results for the preceding quarter and PY ended 31 March is not mandatory. For the quarter ending 30 September, submission of Ind AS compliant financial results and balance sheet for the PY ended 31 March is not mandatory. However, in case the entities intend to submit these results, the same may be without limited review or audit.

In all the above cases, the listed company should disclose with due prominence that the Ind AS compliant financial results, pertaining to the relevant periods of the PY (as mentioned above), have not been subjected to limited review or audit. However, the management has exercised necessary due diligence to ensure that the financial results provide a true and fair view of its affairs.

*For the quarter ending 31 December*

The submission of Ind AS compliant financial results for the PY ended 31 March is not mandatory.

In case a listed entity opts to provide Ind AS comparatives for the period mentioned above to facilitate comparison, the same should be subject to limited review or audit.

• **Disclosure of reserves:** Disclosure of line item ‘Reserves (excluding revaluation reserves)’, as per the balance sheet of the previous accounting year ended 31 March is not mandatory for the first three quarters.

• **Consolidated financial results:** A listed company may opt to present quarterly/YTD consolidated financial results in the second quarter instead of the first quarter of the FY and this option should not change during the remaining part of the FY.

• **Reconciliations to be presented:** Every equity listed entity is required to submit following reconciliations:

  a. Reconciliation of its equity for the PY ended 31 March should be provided while submitting the audited yearly balance sheet.

  Reconciliation of its equity for the PY ended 31 March should be provided in case the listed entity intends to provide the same while submitting the unaudited/audited Ind AS compliant half-yearly balance sheet for the period ended 30 September.

  b. Reconciliation of its net profit/loss as mentioned in the unaudited/audited quarterly financial results should be provided only for the corresponding quarter of the PY.

• **Year-end other than 31 March:** In case a listed entity follows any other FY ending apart from 31 March, then at the time of transitioning to Ind AS and while adopting 31 March as its FY end, the company should disclose with due prominence that the comparative amounts presented are not entirely comparable in the:

  - Quarterly
  - Half yearly
  - YTD
  - Annual financial results.

• **Technical difficulty in interpretation:** At the time of transiting to Ind AS, if a listed company faces any technical difficulty in the implementation of the above mentioned provisions while publishing its financial results, the listed companies should take guidance from the relevant provisions of the Ind AS Rules/AS Rules and Schedule III to the 2013 Act and may opt to make suitable modifications, as applicable.

Further, the listed entities should also provide suitable explanations and clarifications, wherever necessary.

**Debt listed entities**

The SEBI has provided following relaxations to debt listed entities for the first half-year of the adoption of Ind AS:

• **Timelines for submitting half-yearly financial results:** The timeline for submitting the half-yearly financial results have been extended by one month. Accordingly, for the half-year ending 30 September, financial results could be submitted up 14 December of the respective FY.

• **Formats for disclosure of financial results:** The disclosure of half-yearly and annual financial results, i.e. the balance sheet and the statement of profit and loss, should be as per the formats for balance sheet and statement of profit and loss (excluding notes and detailed sub-classification) as prescribed in Schedule III to the 2013 Act. However, banking and insurance companies should follow the formats as prescribed under their respective Acts/Regulations as specified by their regulators.
• **Ind AS compliant comparatives:** With regard to the comparative financial results for the corresponding half-year in the preceding year, the limited review or audit of such comparative half-yearly results is not mandatory.

With regard to the comparative financial results for the preceding full year, the submission of such comparative full year results is not mandatory. However, if the listed entity opts to submit such comparative full year results, then limited review or audit of such comparative full year results is not mandatory.

Further, where the comparative half-yearly results and/or annual results are not subjected to limited review or audit, the listed company should provide adequate disclosure about the fact that:

a. The said comparative results have not been subjected to limited review or audit, and

b. Management has exercised necessary due diligence to ensure that the comparative results provide a true and fair view of its affairs.

• **Reconciliations to be presented:** Every debt listed entity is required to submit following reconciliations:

a. Reconciliation of equity for the previous year ended 31 March (i.e. for the year immediately before Ind AS adoption) should be provided while submitting the annual financial results for the first year of adoption.

Reconciliation of equity for the previous year should also be provided in case the company opts to furnish financial results for the previous year along with financial results for the first half-year, i.e. half-year ended 30 September.

b. Reconciliation of net profit/loss should be provided only for the corresponding half-year in the preceding year.

• **Year-end other than 31 March:** In case a company has previously adopted a FY end apart from 31 March, then such company should disclose, with due prominence, the fact that the comparative figures presented in the half-yearly/annual financial results are not entirely comparable.

• **Technical difficulty in interpretation:** At the time of transiting to Ind AS, if a listed company faces any technical difficulty in the implementation of the above mentioned provisions while publishing its financial results, the listed companies should take guidance from the relevant provisions of the Ind AS Rules/AS Rules and Schedule III to the 2013 Act and may opt to make suitable modifications, as applicable.

Further, the listed entities should also provide suitable explanations and clarifications, wherever necessary.
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IFRS Notes

ICAI issues an exposure draft of amendments to Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance

12 January 2018

Background

The Ministry of Corporate Affairs (MCA) notified the Indian Accounting Standards (Ind AS), applicable with effect from 1 April 2016 to Indian entities in a phased manner. The Ind AS are largely converged with International Financial Reporting Standards (IFRS), except for certain areas of differences (‘carve-outs’) prescribed by the MCA. These carve-outs may be in the nature of a deviation from the IFRS requirements or eliminate an accounting policy choice that exists under IFRS. Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance specifies the manner of accounting and disclosure of government grants and other forms of government assistance received by entities.

New development

On 5 January 2018, the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) issued an Exposure Draft (ED) proposing amendments to certain provisions of Ind AS 20. Comments on the amendments may be submitted to the ASB on or before 24 January 2018.

This issue of IFRS Notes provides an overview of the amendments proposed to Ind AS 20.

First Notes

SEBI relaxes norms governing schemes of arrangements by listed entities

18 January 2018

Background

The listed entities that desire to undertake a scheme of arrangement or are involved in a scheme of arrangement need to follow the regulations laid down by the Securities and Exchange Board of India (SEBI). On 10 March 2017, SEBI issued a circular number CFD/DIL3/CIR/2017/21 which laid down a revised regulatory framework for schemes of arrangements by listed entities and relaxation under Rule 19(7) of the Securities Contract (Regulation) Rules, 1957.

New development

The SEBI received representations to improve the existing framework governing schemes of arrangements. Additionally, SEBI wanted to expedite the processing of draft schemes and prevent misuse of schemes to bypass regulatory requirements. Therefore, on 3 January 2018, SEBI issued a circular number CFD/DIL3/CIR/2018/2 (the circular) to make certain amendments to the circular dated 10 March 2017.

The recent circular is applicable from the date of its issue i.e. 3 January 2018. Some of the key relaxations provided in the circular relate to the following topics:

- Submission of documents to stock exchanges
- Relaxations with respect to locked-in promoter’s shares
- Extended time period for listing of specified securities.

In this issue of First Notes, we have provided an overview of the key amendments/relaxations given in the circular.

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