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**REPORT OF THE COMMITTEE  
ON  
THE COMPANIES BILL, 1997**



**GOVERNMENT OF INDIA  
DEPARTMENT OF COMPANY AFFAIRS  
MINISTRY OF FINANCE AND COMPANY AFFAIRS**

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## Chapter 1

# INTRODUCTION

1. The Companies Act, 1956 which has been on the statute book for over four decades by now, was enacted with the object to amend and consolidate the law relating to companies and certain other associations. The present Act came into being w.e.f. 1<sup>st</sup> April, 1956 by repealing the Indian Companies Act, 1913 following the recommendations of the Company Law Committee (Bhabha Committee).

1.2 In August, 1977, the Government appointed a Committee under the Chairmanship of Justice Rajinder Sachar to review the Companies Act, 1956 and the Monopolies and Restrictive Trade Practices Act, 1969. Some of the recommendations of the Sachar Committee led to the amendments in the Companies Act during the years 1985 and 1988. However, while considering the proposals, which led to the enactment of the Companies (Amendment) Act, 1988, a decision was taken by the Government for a comprehensive review of the Companies Act, 1956.

1.3 In the wake of economic reforms process initiated from July, 1991 onwards, the Government recognised that many provisions of the Companies Act had become anachronistic and were not conducive to the growth of the Indian corporate sector in the changing environment. Consequently, an attempt was made to recast the Act, which was reflected in

the Companies Bill, 1993. The said Bill, however, was subsequently withdrawn. As part of continuing reforms process and in the wake of enactment of the Depositories Act, 1996, certain amendments were, however, incorporated by the Companies (Amendment) Act, 1996.

1.4 In the year 1996, a Working Group was constituted to re-write the Companies Act, following an announcement made by the then Union Minister for Finance in his Budget Speech to this effect. The main objective of the Group was to rewrite the Act to facilitate healthy growth of Indian corporate sector under a liberalised, fast changing and highly competitive business environment. Based on the report prepared by the Working Group and taking into account the developments that had taken place in corporate structure, administration and the regulatory framework the world over, the Companies Bill, 1997 was introduced in Rajya Sabha on August 14, 1997 to replace by repealing Companies Act, 1956. In the meantime, as part of reforms process and in view of the urgency felt by the Government, the President of India promulgated the Companies (Amendment) Ordinance, 1998 on October 31, 1998, which was later replaced by the Companies (Amendment) Act, 1999 to surge the capital market by boosting morale of national business houses besides encouraging FIIs as well as FDI in the country. The amendments brought about number of important changes in the Companies Act. These were in consonance with

the then prevailing economic environment and to further Government policy of deregulation and globalisation of economy. The corporate sector was given the facility to buy-back company's own shares, provisions relating to investments and loans were rationalised and liberalised besides the requirement of prior approval of the Central Government on investment decisions was dispensed with, and companies were allowed to issue "sweat equity" in lieu of intellectual property. In order to make accounts of Indian companies compatible with international practices, the compliance of Indian Accounting Standards was made mandatory and the provision for setting up of National Committee on Accounting Standards was incorporated in the Act. For the benefit of investors, provisions were made for setting up of "Investor Education and Protection Fund" besides introduction of facility of nomination to shareholders, debenture holders etc.

1.5 The year 2000, witnessed another bouquet of amendments in the form of Companies (Amendment) Act, 2000 in order to provide certain measures of good corporate governance and for ensuring meaningful shareholders' democracy in the working of companies. The reforms made through these amendments include setting up of Audit Committee, introduction of Postal Ballot and Shelf Prospectus, abolition of the office of the Public Trustee, goodbye to the concept of "Deemed Companies", removal of

procedure whereby Central Government used to appoint auditors in the Government companies, restricting a person to become director in not more than 15 companies, prohibiting an auditor to hold securities carrying voting rights, introduction of secretarial compliance certificate to ensure better compliance of Companies Act by smaller companies, deletion of redundant provisions relating to managing agents, secretaries and treasurers and increase in penalties to ten fold than the existing penalties.

1.6 It will thus be observed that after introduction of the comprehensive Companies Bill, 1997, major amendments in the Companies Act were carried out in 1999 and 2000. These changes include many landmarks in the direction of decontrol, de-regulation, simplification and rationalisation. The corporate sector was given more freedom and flexibility to decide its affairs and self-regulation subject to certain conditions was encouraged. The emphasis was on shareholders' democracy by passing required resolutions in General Meetings rather than seeking Government approval on major decisions on the working of companies.

1.7 Corporations today are not bound by geography. A lot of changes have taken place in economic environment of the country and the corporate sector in particular, due to market oriented policies introduced by the Government since

1991 and emergence of new multilateral trading system under the aegis of World Trade Organisation. The modern economy is witnessing a dominant role being played by companies as important vehicle to accelerate the process of development.

1.8 The changes brought out by globalisation and digital technology have already reached far and wide, compelling companies to re-engineer and re-script all aspects of their activities, leading to emergence of complex corporate structures and consequently the new concepts. Moreover, growing demand for good corporate governance, corporate social responsibility and good corporate citizenship are predominantly influencing company law reforms the world over.

1.9 Notwithstanding the two major Amendment Acts having been passed in the Companies Act during the last 3 years, there are still areas, which need to be further rationalized in order to ensure smooth and efficient functioning of companies. For example, there are even now number of items on which companies have to take prior approval of the Government. This not only delays decision making process of companies but sometimes also adversely affects their business relations internationally besides it dissuades the initiative and drive to make changes for the better. These issues have been debated and considered for rectification at the time of drafting the Companies Bill,



1997, which is still pending in the Parliament. Keeping in view the changes already made in the Companies Act, it is considered desirable to have a fresh look at this Bill in order to identify what further changes are urgently required to be made in the Act. This is necessary to give further boost to our companies so that they can fine tune their working in line with international business practices and compete globally with multinational companies. It is with this objective in view that the Department of Company Affairs has constituted a Committee on April 4, 2002 (Appendix-I) consisting of the following to examine the remanants of the Companies Bill, 1997:-

S. No.	S/Shri	
1.	R D Joshi, Director General, (Investigation & Registration)	Chairman
2.	Rajiv Mehrishi, Jt. Secretary, DCA	Alternate Chairman
3.	V K Bhasin, Joint Secretary, Ministry of Law & Justice	Member
4.	S B Mathur, DII (Retd.)	Member
5.	Ashok Haldia (Dr.), Secretary, ICAI	Member
6.	S P Narang (Dr.), Secretary, ICSI	Member
7.	E Selvaraj, JD(T)	Member
8.	S K Sharma AD (I)	Member
9.	S P Dixit, JD (L)	Member Secretary

1.10 The Committee held seven meetings and discussed important provisions of the Companies Bill, 1997. The views of the Committee with regard to further changes required to

be made in the Companies Act, 1956 are discussed further down in this Report.

## CORPORATE GOVERNANCE

2.1 In the dynamics of development, Good Corporate Governance has emerged as the most powerful propellant for long-term sustainability of corporate growth and competitive advantage of corporate sector. Corporate governance is an art of managing companies ethically and efficiently for enhancing stakeholders' value. Lack of practising good governance at various levels is instrumental in impeding the actual economic growth. Forward-looking corporates in India have voluntarily put in place systems of adherence to good corporate governance practices. Increasingly corporates are recognising that adherence to the norms of internationally accepted corporate governance is indispensable for survival and growth.

2.2 There is a complex interplay of factors, which contribute to the functioning of corporate governance system. There are factors internal to the firm such as the Board of directors, providers of capital, stakeholders, and management. Likewise external factors include law and regulation, competitive markets, transparency, accountability and high standards of reporting. In other words, corporate governance relates to overseeing functioning of the top management, particularly, the Board of directors. The basic pre-requisites are invariably trust, honesty, transparency accountability etc.

in pursuit of its objectives in managing the attendant internal and external inter-relationships. There is growing public opinion, which expects a business enterprise to be, much more than a mere economic unit, for example, to be a good corporate citizen it is warranted of it to contribute generously for social and philanthropic purposes. The entire gamut of corporate governance system could be thus referred to "corporate ethical and value system". Corporate governance systems as evolved over centuries, have often found to be deficient in responding to corporate failures and system crisis. However, new urgency has been lent by the global financial crisis, which unleashed unprecedented volatility in markets, led to devaluation, default and capital flight. Reform on governance can no longer be viewed as a national or local issue for any corporation. Globalization has brought in its wake the need for international coordination of effort to ensure that growth is sustained and shared.

2.3 In India, despite a long corporate history the phrase 'corporate governance' remained unknown until 1993. It came to the fore due to spate of corporate scams and fraudulent practices during the first phase of economic liberalization and thereafter in successive recurrence. These incidences led to the prominence of corporate governance within the corporate body/sector, financial institutions, enlightened business associations, the

regulating agencies and the Government. Good governance is imperative for edge in competition and critical to economic and social progress. In an ever-increasing globalised economy, firms need to tap domestic and international capital markets for investment but capital providers have choice and the quality of corporate governance is increasingly becoming a deciding factor for investment and lending. Enlarging and deepening the capital pool for developing and transition economies requires full attention to corporate governance standards. This sets the imperatives for reform.

2.4 A new era of good corporate governance has been put in place with the enactment of Companies (Amendment) Act, 2000. The Amendment Act is in line with changing needs of the corporate sector infused in the wake of globalisation. The thrust being on the good corporate governance, the Amendment Act aims at making Indian corporate sector as a whole and its corporate bodies as respected and well to do citizens globally so that they enjoy the confidence of investors and other stakeholders including consumers (Indian as well as foreign). With a view to ensure greater transparency and accountability, a new section 292A has been incorporated requiring every public company having a paid up capital of rupees five crore or more to constitute an Audit Committee. The Committee is required to have discussions with the auditors periodically

about internal control systems, the scope of audit including the observations of the auditors and to review the half yearly and annual financial statements before submission thereof to the Board and also to ensure compliance of internal control systems. Companies are also required to include in their Directors' Report, a Statement of its Director's responsibility. The Company Secretaries have been given a major responsibility for ensuring legal governance. An obligation has been cast upon every company not required to employ a whole-time secretary and having a paid up share capital of ten lakh rupees or more to file with the Registrar of Companies, a certificate from a Secretary in whole-time practice to the effect that the company has complied with all provisions of the Act and a copy thereof is required to be attached with the Board's Report. In section 274 of the Act, additional disqualifications for appointment as a director have been prescribed. A person, who is a director of a public company which has not filed the annual accounts and annual returns for any continuous three financial years commencing on or after the first day of April 1999 or which has failed to repay its deposits or interest thereon on due date or redeem its debentures on due date or pay declared dividend and such failure continues for one year or more, has been debarred from being eligible for appointment as a director of any public company for a period of five years from the date the default is committed. With a view to ensure that directors devote more time in the

activities of the companies in which they are directors, a person has been prohibited from holding the directorship in more than fifteen companies. In a public company having paid up share capital of five crore rupees or more and also one thousand or more small shareholders of whom each holds shares of nominal value of twenty thousand rupees or less may have a director elected by such small shareholders in the manner prescribed. A new section 192A have been inserted which requires listed companies to pass certain resolutions by postal ballot instead of transacting the business in general meeting.

2.5 The changes incorporated in the Companies Act to strengthen corporate governance mechanism have been received well. The corporates in India have realised the importance of good corporate governance and there are indications that they are in the process of establishing good governance mechanisms. However, as far as the Companies Act is concerned some measures are still to be incorporated to ensure inbuilt statutory framework for good corporate governance. In this respect, the Committee suggests few more changes in the Companies Act and these are discussed hereinafter.

## Verification of Persons Forming Companies

2.6 Section 15 of the Act requires that the Memorandum of Association of a company shall be signed by each subscriber who shall add his address, description and occupation, if any. As such, when a new company is formed the subscription clause of its memorandum is required to contain the details of its subscribers such as their addresses, description and occupations etc. These details are merely required to be attested by a witness. There is, however, at present no procedure of verification of the declarations made and the Registrar accepts these details in the form these are presented in the Memorandum by persons (subscribers) desirous of forming the company. Empirical evidence corroborates that certain companies disappeared and their subscribers eloped soon after collecting funds from the public through public issues of shares, debentures, bonds or mobilisation of deposits etc. In the absence of adequate data of persons at the helm of such companies enormous problems are being faced in locating and initiating legal action against such vanishing companies and their alleged delinquent subscribers/directors/promoters. Therefore, it is proposed that a subscriber to the memorandum shall be required to furnish details of his/her Permanent Account Number (PAN), Identity Card issued by Election Commission of India etc. along with his/her address/description, occupation and proof of his/her



identity. This will help to trace out the unscrupulous persons who disappear, elope or impersonate after cheating the public through the mode of companies formed by them for such deceitful purposes.

### **Prohibiting Promoters to withdraw once having subscribed to a Public Issue**

2.7 One way for companies to raise capital is by floating a public issue of shares by issuing a prospectus where under a particular time frame is indicated within which time the public is asked to make its application. An application for shares is as a matter of fact only a proposal to buy shares and like all other proposals this can be withdrawn by the applicant before its acceptance. Section 72(5) of the Act provides that application for shares in, or debentures of a company, shall not be revocable until after the expiration of the fifth day after the time of opening of the subscription lists. However, it has been observed that certain unscrupulous promoters first subscribe to the issue and/or purposely follow up by public announcement to this effect to create and enhance public confidence and then surreptitiously withdraw their application for subscription. Such a malpractice needs to be curbed forthwith. It is, therefore, proposed to prescribe that persons described in the prospectus as promoters or directors including relatives thereof and who have applied pursuant to such prospectus shall not be entitled to revoke

their application for shares or debentures once having been made.

## Prohibition on distribution of Gifts

2.8 At present, there is no provision in the Act, which prohibits the companies to distribute gifts at the time of general meetings or otherwise. At times, this creates problems for companies as certain unscrupulous shareholders pressurize the Board of directors at the general meetings to distribute gifts either in cash or kind to the shareholders present at the meeting. This not only gives undue advantage to those who are able to attend the general meetings of the company vis-à-vis those who are unable to attend for various reasons including long distance involved between place of residence and place of general meeting. Moreover, such unscrupulous shareholders often succeed in creating unruly scene, disorder, and chaos at the general meetings. Absence of specific prohibition also gives leverage to unscrupulous promoters/directors to abuse this method and get their resolutions passed by alluring such shareholders present at the meeting with gifts. Such practice acts as two sharp edged sides of a blade and thereby undesirable as resultant effect is bleeding of public interest profusely. It is, therefore, proposed to prohibit a company to give or for a shareholder to demand or accept any gift either in cash or kind at any general

meeting or otherwise. For this purpose, 'Gift' will not, however, include any discount coupon or any food or beverage offered at a general meeting by the company management.

## Restriction on number of Directors

2.9 There is no maximum number of directors, which a company can appoint, has been prescribed at present. This has resulted in many companies having more than 15 directors. It is desirable to place a restriction in this behalf so that the Board of directors becomes compact and effective. It is proposed that the maximum number of directors which a public limited company can appoint should be restricted to fifteen and in case of private limited company it should be not more than twelve. Under Section 259 of the Companies Act, the Central Government has powers to approve appointment of directors on the Board of a company beyond what its Articles permit. This practically means that the size of the Board can have no outer limit if allowed by the Government. It has resulted in having Board of directors which is large in size and non conducive to transact business in effective manner. Since it is now proposed to restrict mandatorily the number of directors on a Board by amending Section 252, there is no need to retain Section 259 and this is, therefore, proposed to be deleted.

## Powers of the Board

2.10 Section 292 of the Act specifies certain powers, which can be exercised by Board only by means of resolutions passed at the meeting of the Board and not by passing resolution by circulation. It is proposed to include following powers in the aforesaid section:

- (i) the power to issue securities whether issued in or outside India;
- (ii) the power to approve the annual reports, the profit and loss account and the directors' report, or wherever required half yearly accounts;
- (iii) the power to approve amalgamation, merger, reconstruction; and
- (iv) the power to make contributions to charitable or other funds.

It is felt that aforesaid matters are very important for a company and require face to face deliberations of the members of the Board before the same are approved or otherwise. Before consenting to issue of securities, the Board of directors is expected to make due diligence and consider various issues relating thereto such as pricing and timing of issue, project appraisal report, promoter's contribution, contents of offer documents etc. which are very crucial and cannot be effectively

deliberated and decided by a circular resolution. Approval of annual/half yearly accounts also needs thorough understanding of the financial statements and Board has to consider critically various matters arising out of accounts such as transfer of profits to reserves, proposed dividend, depreciation policy, writing off bad debts etc. Therefore, it is proposed that these powers must be exercised by Board only at its meeting and not through passing resolution by circulation. The power to approve amalgamation, merger, reconstruction involves a number of strategic decisions such as transfer date, exchange ratio, etc. which also need to be passed at Board Meeting only. Similarly, the power to make contributions to charitable or other funds is a major decision having financial implications, which ought to be decided at a Board Meeting only. It shall also be explicitly provided that the Board shall not be authorised to delegate powers in respect of these items of business to a Committee thereof.

## **Retiring Age of Directors**

2.11 Presently the Companies Act, 1956 does not provide for retiring age of a managing director, whole-time director or other director of a company. Consequently, directors continue to hold senior positions in the Board such as Chairman, Managing Director etc. even if they have attained age of 75-80 years or so. This happens regardless of the

fact that at times the person holding such position may not be having sound health or may suffer from infirmities, which may hinder him in performing an effective role as senior management person of the company. A manager today has to work in a complex business environment. The activities of companies are becoming global and they have to be in strong positions to stand in the highly competitive global environment. The position of managing director, whole-time director, manager and directors of a company is, therefore, a strategic position, which requires innovative business ideas and their effective implementation. The senior persons holding such position, therefore, should be in perfect health with an alert mind. They should in no way be handicapped in meeting the challenge which the present day complex business environment is capable of generating every now and then. It is, therefore, felt imperative that a ceiling on retirement age be provided by inserting a provision that no person shall be eligible to hold office as a managing director, whole-time director or other director or manager of a public limited company, if he has attained the age of seventy-five years. However, directors who have crossed the age prescribed and who are currently holding their posts will be allowed to continue till their present term expires. The ceiling shall not apply to a private limited company unless it is a subsidiary of a public company.

## INVESTORS PROTECTION

3.1 The financial sector and capital market reforms over last one decade have resulted in substantial growth and at the same time brought transparency in the capital market operations. The Companies Bill, 1997 contained number of provisions for promoting better corporate governance in general and for safeguarding the interest of small investors in particular. Considering the urgency, most of the provisions in regard to protection of interest of small investors were given effect through the Companies (Amendment) Acts of 1999 & 2000. These included:

- ❖ requiring companies to intimate details of default in repayment of deposits or part thereof to small depositors to the Company Law Board;
- ❖ providing for appointment of debenture trustees and for creation of security and debenture redemption reserve;
- ❖ providing for passing of resolution by postal ballot; and
- ❖ providing for establishment of "Investor Education and Protection Fund".

3.2 Yet another piece of a very important amendment has already been moved by Government through Companies (Amendment) Bill, 2001. The said Bill seeks to provide for an alternative framework for expeditious and effective measures for revival, reconstruction, rehabilitation or winding up of companies in the interest of investors, creditors and public. When enacted it will make the winding up process faster so that the useful assets of the company are liquidated in a speedier manner and the proceeds are distributed quickly to investors of the company as per provisions of law. However, going through the remaining provisions of the Companies Bill, 1997, it is felt that some more investor friendly measures can be enacted in order to provide transparency and fair play in the operation of a corporate entity. These measures are discussed below: -

### Unclaimed Dividends

3.3 Sub-section (5) of Section 205A of the Act provides for transfer of unpaid or unclaimed dividend to "Investor Education and Protection Fund" established under sub-section (1) of section 205C after expiry of seven years from the date of transfer of such dividends to unpaid/unclaimed dividend account. After expiry of aforesaid period of seven years, no shareholder can claim and have retrieval of the amount of unpaid/unclaimed dividend. In practice it is, however, noticed that there are number of



shareholders who are unable to get their dividend due to various reasons. There is no requirement of law at present, which casts an obligation on the company to inform the shareholder who has either not been paid dividend or who has not claimed the dividend already declared by the company. This causes undue hardship especially to small investors who may not be aware of dividends declared by the company. It is, therefore, proposed that every company which has transferred the amount of dividend to Unpaid/Unclaimed Dividend Account to mandatorily inform through the notice for AGM every year each person whose dividend remains unpaid or unclaimed until such dividend is paid or the expiry of seven years from the date of such transfer whichever is earlier. This will mitigate the avoidable hardship to such investors.

### **Delay in Payment of Application Money**

3.4 The Companies Act permits companies to raise capital from public by issue of prospectus. While issuing prospectus for subscribing to its shares companies are also required to indicate the minimum amount they propose to raise through the allotment. In the event of inadequate response for subscription from public, companies are under obligation to abandon the public issue and refund application money to subscribers within a stipulated time frame. Section 69 of the Act provides that if a company

does not repay the application money within 130 days after the issue of prospectus to the applicants, the directors of the company shall be jointly and severally liable to repay that money with interest at the rate of six per cent per annum from the expiry of 130<sup>th</sup> day. It is felt that the rate of interest prescribed is very low and does not act as deterrent. Therefore, it is proposed to increase the rate of interest from 6 per cent to 15 percent per annum. Such an amendment will dissuade directors/promoters not to inordinately delay refund of application money and in the eventuality of delay beyond prescribed time, the investor will be adequately compensated for having been deprived of his money.

### **Service of Notice by Courier and Electronic Means**

3.5 Section 51 of the Act provides for mode of service of notice to a company or officer by post under a certificate of posting or by registered post or by leaving it at its registered office. A company provides similar mode under sections 52 and 53 of the Act with regard to service of documents to Registrar and service of documents on members. These days there are variety of new modes of transmission of post, which are in operation such as speed post, courier services and e-mail etc. Since these modes were nonexistent at the time of enactment of Act, they do not find place in these provisions. These newly emerged

modes are now being used frequently by companies as well as by Registrars and infact enjoy legal sanctity in most of the developed countries. It is, therefore, proposed that the improved means of communications such as speed post, courier and electronic mail should also be allowed as acceptable mode of service of notice/documents in addition to existing modes for the purpose of service of notices/documents etc. in Sections 51, 52, and 53 of the Act. This will provide a legally valid wider choice to the companies to serve notice to members and send documents to Registrar of Companies and also to receive notices from other persons by speed post, courier or e-mail, etc.

### **Enlarging scope of explanatory statement to be annexed to notice**

3.6 Presently, the Explanatory Statement annexed to the notice of a meeting in respect of a special business requires inter-alia the company to disclose nature of concern or interest, if any, therein, of every director and manager. While this disclosure takes care of information about director's interest it does not cover cases where a director's relative is involved or he has a pecuniary interest in the transaction. It is, therefore, desirable in the interest of proper governance that the present provision about disclosure should be further strengthened by requiring a company to disclose the financial implications and specific nature of the interest of any director/manager

and/or his relative, if any, in such a manner so as to enable a shareholder to take a view on a proposed issue in a meaningful manner. The company should also be required to give 'particulars of the shareholding interest of the director's relative in that other company'. It is also suggested that a liability be cast on director or manager for non-disclosure or insufficient disclosure, to hold in trust, the benefits received by him, directly or indirectly and reimburse or compensate the company. Similarly, penal provisions for default should also need to be strengthened by providing imprisonment for a term which shall not be less than six months but which may extend to five years and fine which shall not be less than fifty thousand rupees.

### **Chairman of Audit Committee to Attend Annual General Meetings**

3.7 Sub-section (10) of section 292A of the Companies Act, 1956 provides that the Chairman of the Audit Committee shall attend the Annual General Meeting of the company to provide any clarification on matters relating to audit. There may be situations when the chairman of the Committee is unable to attend annual general meeting of the company for reasons beyond his control. This would amount to default under this section and Chairman can be prosecuted for this lapse. It is felt that this stipulation is very strict and compliance of the same is impracticable in certain conditions. The law presently does not provide for

such a compulsory presence of Chief Executive/Chairman/or other Directors of the company in the Annual General Meeting. It is felt that a provision regarding alternative arrangement need to be incorporated in the Act. It is, therefore, proposed that in the event of Chairman's inability to attend the AGM, the Audit Committee may nominate any other Member of the Committee to attend the AGM, in place of the Chairman, to provide any clarification with regard to audit.

## Chapter 4

# DEREGULATION AND PROCEDURAL SIMPLIFICATION

4.1 India reoriented its economic policies in 1991 to usher in a new era of deregulation, liberalisation and global integration. Since then significant policy initiatives were introduced to provide stimulus for accelerated economic growth and to inject new equations of competition in order to catalyse greater industrial efficiency and international competitiveness. The reforms inter alia aim at deregulating the economy to provide Indian industry greater flexibility to respond to competitive pressures by reducing cost and improving quality. The reforms include large-scale procedural simplification, removing bottlenecks that hinder the growth and development of the industry and to provide a conducive administrative environment to enable corporates in India to develop and grow.

4.2 Beginning July, 1991, the Government also initiated the process of standardisation, harmonization, rationalisation and simplification of company law as part of overall economic reforms process, with a view to align it with the national regulatory and administrative environment conducive for the successful implementation of market oriented reforms policies. As part of the deregulation and procedural reforms, the Government in recent past took

various measures by amending the Companies Act, 1956. These measures have been taken to ensure that there is no unnecessary administrative intervention in the functioning of the companies in India. These measures include deletion of the requirement of obtaining confirmation of Company Law Board for amending the object clause of the Memorandum of Association. Now, the companies can change their object clause by passing a special resolution. Companies have also been allowed to buy back their own securities and are not required to obtain the approval of Central Government for inter corporate loans/investments as per newly inserted Section 372A. Microfilms, facsimile copies of documents, computer printouts and documents and computer media are now recognised as documents and have been conferred evidentiary value. The companies are also allowed to issue "sweat equity" and issue shares to employees under ESOPs with a view to retain talent in the company. The requirement of stamping of transfer instruments has been dispensed with in the case of transfer of shares in depository system. The limits under Schedule XIII for payment of remuneration to managerial personnel by a company having losses or inadequate profits have been enhanced considerably and such companies have been permitted to pay increased remuneration without seeking approval of the Central Government.

4.3 However, the Government's objective of providing hassle free business environment requires further

deregulation and procedural simplification under the Companies Act. The Central Government approval is still required under number of provisions of the Companies Act, which at times act as bottleneck in the proper functioning of the companies and thus adversely affect the interest of the companies and consequently that of shareholders as well. Central Government approval is still necessary for appointment of sole selling agents, making loans to directors and holding of office or place of profit by a relative of a director etc. The Committee feels that these and some others similar restrictions, which exist in the Companies Act, need to be removed to provide companies flexibility in the management of their affairs. The Committee, therefore, suggests following specific changes to further simplify the Act procedurally:-

### **Appointment of Sole Selling Agents**

4.4 Section 294AA of the Act provides that if a person to be appointed as a sole selling agent having substantial interest in the company, the appointment has to be previously approved by the Central Government. The section also stipulates that a company having a paid-up share capital of Rs. 50 lakhs or more, it shall not appoint a sole-selling agent except with the consent of the company accorded by a special resolution and the approval of the Central Government. The concept of appointment of sole



selling agent has been in use in the trade in special situation where demand for any goods and service is less than the supply. The company has to appoint sole selling agent to create and stimulate the demand so that it can sell its goods. The question as to whether a company needs to have sole selling agent or not, is a business proposition and ought to be left to the prudence of management. As a safeguard, it is sufficient if such proposal is approved by a special resolution in the general meeting. The Central Government approval for such appointment, which is required presently, is considered unnecessary and prohibitive to business initiative of the trade. The same is, therefore, proposed to be withdrawn. However, for sake of transparency it is also proposed that where sole selling agent has substantial interest in the company, the Board's report for each financial year should give particulars relating to such sole selling agent as a separate item. At present, there are three sections namely, section 294, 294A and 294AA dealing with appointment of sole selling agent and for the sake of clarity and brevity, it is desirable that these three sections are combined and replaced by a composite section.

### **Loans to Directors**

4.5 Section 295 of the Act governs grant of loans, giving guarantee or providing any security in respect

thereof to a director etc. by requiring companies to get prior approval of the Central Government. Grant of such loans normally depends on availability of resources with the company and the nature of the personal requirements of a director. Sometimes, it becomes necessary to provide such loans to hire or to retain occupants of senior management positions in the company. The Government control in the form of obtaining approval by the company is considered unnecessary in the present day business atmosphere. It would suffice if there were transparency in grant of such loans and is supported by special resolution expressly passed by shareholders of the company. It is, therefore, proposed to dispense with present day requirement of obtaining prior approval of Central Government for making loans to director or managing or whole time director etc. and the company will now be required to get prior approval of the members by passing a special resolution for this purpose. It is also proposed that the loan to a director shall be confined to meet expenses on medical treatment, purchase or construction of residential house and education of children only. The amount of loan shall be restricted to five times of annual remuneration.

### **Director's interest in contracts**

4.6 Section 297 of the Act requires previous approval of the Central Government for entering into

contracts for sale, purchase or supply of any goods, materials or services or underwriting the subscription of shares in, or debentures with a director or his relative etc. in case the paid-up share capital of the company is not less than rupees one crore. In view of the liberalization policy of the Government and to reduce the Government's intervention in such transactions and to give boost and flexibility to Indian business so that it becomes competitive with global business, it is proposed to dispense with the requirement of obtaining previous approval of the Central Government for the aforesaid contracts by omitting proviso to sub-section (1) of section 297 of the Act. Such a proposal should, however, be approved by the Board at a meeting before the contract is entered into or in urgent situation within three months of the date on which it was entered into. Another provision in the same section stipulates that where the value of goods and material exceeds Rs. 5,000 the exemption available at present for such contracts will not be applicable. In view of general inflationary trend including overall scenario, it is proposed to increase this exemption limit from Rs.5,000/- to Rs. 50,000/-.

### **Appointment of Relatives**

4.7 Section 314(1B) provides that - (a) no partner or relative of a director or manager, (b) no firm in which such

director or manager, or relative of either, is a partner, (c) no private company of which such a director or manager, or relative of either, is a director or member, shall hold any office or place of profit in the company which carries a total monthly remuneration of not less than rupees 20,000 except with the prior consent of the company by a special resolution and the approval of the Central Government. Today, the business has become very competitive. Companies have to face the challenges not only from competitors within India but from multinational corporations as well. To manage this situation, the companies have to professionalise their management and employ only persons who are well educated, trained and have specialised skills. In this scenario, no management of a company can afford to employ a relative who does not fulfill these requirements and pay him an unreasonably high salary. It is, therefore, proposed to dispense with the present requirement of obtaining approval of the Central Government for such cases. However, approval of shareholders by way of special resolution shall continue to be a condition precedent to such appointment. Further, it would be sufficient compliance if the special resolution is passed at a general meeting of the company held for the first time after the holding of such office or place of profit.

## Restriction on transfer of shares

4.8 Sections 108A-108H were introduced in the Companies Act, 1956, by the Amendment Act of 1974 to regulate the acquisition and transfer of shares of a body corporate owning any undertaking to which the provisions of Part A of Chapter III of the MRTP Act apply. They were intended to prevent acquisition or take over of companies leading to further concentration of economic power. These sections were omitted from the Companies Act and incorporated in Chapter III-A of MRTP Act in 1984. They witnessed yet another shift in 1991 when these were restored again to Companies Act by MRTP (Amendment) Act, 1991 primarily because the concept of MRTP undertaking was omitted from the MRTP Act through this amendment. The Committee, therefore, noticed that the MRTP (Amendment) Act, 1991, removed the concept of MRTP undertakings. SEBI has also since issued SEBI (Substantial Acquisition of Shares & Takeovers) Regulations, 1997 to provide greater transparency in the acquisition of shares and the takeover of the companies through a system of adequate disclosure of information. Moreover, combinations beyond a high threshold limit inter-alia through the process of acquisition of shares including voting rights etc. are proposed to be subject of scrutiny by the Competition Commission of India in terms of Competition Bill, 2001 which is presently under consideration of Parliament. In these changed circumstances,

it is felt that the sections 108A-108-I have outlived their utility and thereby become redundant and consequently need to be deleted.

## FINANCIAL REPORTING

5.1 The lifeline of market is information and any factor, which prevents, restricts or distorts the flow of adequate and relevant information contributes to imperfections in the market. There is strong companionship between better transparency and accurate valuation of securities. In recent years, there has been an increasing sense of urgency surrounding the need for responsible financial reporting. At the same time, the demands on the flexibility of financial reporting have also become increasingly intense with the growing sophistication of financial instruments to manage risks. Needless to state that competitive edge drives corporate restructuring which is mainly based on information. The recent turmoil in foreign markets has further heightened the need for sound financial reporting. The basic principle of financial reporting is that the view presented should be true and fair. The Boards should make all relevant disclosures in a manner that the information given is understandable to an ordinary shareholder. This goal should not be tampered with a desire to avoid damage to company's competitive position. They should also aim to ensure the integrity and consistency of their reports, which should meet the reporting standards both in letter and spirit. Studies have shown that the most widely read part of company's report is the opening statement. Obviously, it should provide a

balanced and readable summary of the company's performance and prospects. It should represent the collective view of the Board. Today, Indian corporates are striving hard towards establishing their identity as global corporates and GDRs, ADRs have become the favoured new source of capital for them. To source external capital, the company not only has to have a global perspective but also follow internationally accepted practices with regard to Financial Reporting. One of the established international practice that an Indian corporate has to follow is recasting its financial statements (prepared as per Indian GAAP) in accordance with US GAAP. As the global financial markets are fast integrating and Indian corporates are exploring the foreign markets for raising funds, it is no longer possible to follow two yardsticks for disclosure of financial and accounting information, one for domestic investors and another for foreign investors. Indian accounting standards can no longer afford to remain isolated from worldwide trends. They must be able to provide a fair and transparent system of information flow from the business organisations to the users of such information, taking into account the ever-increasing need for information of the user. In this regard, the Companies (Amendment) Act, 1999 inserted a new section 210A providing for constitution of a National Advisory Committee on Accounting Standards to advise the Central Government on the formulation and laying down of accounting policies and accounting standards for adoption



by companies or class of companies. The Kumarmangalam Birla Committee has rightly recommended the introduction of four accountings standards namely consolidated reporting by holding companies, segmental reporting, disclosure of related party transactions and tax effect accounting. These standards are important for improving transparency in financial reporting. Though, financial reporting and accounting standards in India have been upgraded yet this being a continuous process, there is a need to bring about harmonization and synchronisation amongst Indian accounting standards with the global ones.

5.2 The annual audit is one of the cornerstones of corporate governance. Given the separation of ownership from management, the directors are required to report on their stewardship by means of the annual report and financial statements. The audit provides an external and objective check on the way in which the financial statements are prepared and presented. The question is not whether there should be an audit, but how to ensure its objectivity and effectiveness. The auditors' role is to report whether the financial statements give a true and fair view, and the audit is designed to provide a reasonable assurance that the financial statements are free from material misstatements. The auditors' role is not to prepare the financial statements, nor to provide absolute assurance that the figures in the financial statements are correct, much less

to provide a guarantee that the company will continue to be in existence. There is a problem of so-called 'expectations gap' - the difference between what audits do achieve and what they ought to achieve. The expectations gap is damaging not only because it reflects unrealistic expectations of audits but also because it led to disenchantment with their value. In order to narrow the expectations gap, there is need for clarity about the respective responsibilities of directors and auditors for preparing and reporting on the financial statements of companies.

5.3 No doubt the Board is responsible for the prevention and detection of fraud and other illegal acts, as part of its fiduciary responsibility for protecting the assets of the company. The auditors' responsibility is to plan, perform and evaluate his audit work so as to have a reasonable expectation of detecting material misstatements in the financial statements. The fraud may involve forgery, collusion or management override of control systems. Sometimes the auditor may suspect the top management itself being a party to the fraud, but he may lack the necessary evidence to back up his suspicions. In such a situation he may not be in a strong position to confront management but he may have a case, which he can report to the appropriate authorities for action. The question is whether he should report such cases. One view is that the auditors should have a duty to report fraud to the appropriate authorities.

The other view is that it is not the part of his statutory duty as per the provisions of existing law. There is yet another scenario wherein it is feasible that auditors even if they detect some misappropriation or misstatement in accounts by management they do look other way and do not record such lapses in their statutory report. Such omissions, which are intentional, make an auditor party to the conspiracy to defraud the investors by misrepresenting the financial position of the company. It also makes them equally guilty in the fraud alongwith the management of the company. There is no specific provision in the Companies Act at present to deal with such situations, which lead to falsification of accounts. Such a provision need to be enacted now in the interest of public, investors, financiers and tax authorities etc. The amendments suggested in the area of financial reporting are discussed below:-

### **Officer who is in Default**

5.4 Section 5 defines the term 'Officer who is in default' for the purpose of fixing the responsibility with regard to compliance of the provisions of the Act on certain categories of persons. The definition presently includes the Managing Director, Whole-Time Director, Manager, Secretary, person charged with the responsibility of complying with specific provisions of the Act, etc. by the Board. This definition, however, does not include the

auditors and independent directors. The role of independent directors has in today's context, increased and they are expected to assume the responsibility of ensuring the compliance of the provisions of the legislations governing the affairs of companies. It is, therefore, proposed that the scope and ambit of 'Officer who is in default' be amplified so as to include independent directors in respect of any contravention of the provisions of the Companies Act which has taken place with his consent or connivance or is attributable to neglect on his part. It is also proposed to include "Chief Accounts Officer" in the definition of 'Officer who is in default' to make him responsible in respect of financial reporting and other accounts matters.

### **Consolidation of Accounts**

5.5. Preparation of consolidated accounts within the group is an internationally established practice. This helps investors to get first hand information about the group as a whole for taking an informed decision for investment. This also helps Financial/Lending Institutions/Banks to take decision for financing. In view of globalisation of the economy, it is very useful and advantageous for the companies to prepare their group accounts. It is, therefore, proposed to make a provision in the Companies Act providing for preparation of consolidated accounts mandatorily by a holding company as and when

notified by the Government. It is further proposed that a holding company alongwith its Annual Reports need not attach annual reports of its subsidiary companies where such holding company prepares group accounts for itself and its subsidiaries as required by law.

## Rotation of Auditors

5.6 As per the present provisions of the Act, a retiring auditor shall be re-appointed unless such a person is not qualified for re-appointment or some other person has been appointed in his place. It is, however, seen in practice that the same auditors are reappointed from year to year without any break. There are cases where corporate houses or corporate groups get associated with certain accounting firms and the same firms are employed to audit companies in these groups year after year. This over a period of time leads to establishing a nexus between the management and auditors. There have been cases where auditors collude with management by adopting malpractices in reporting facts to the shareholders. In order to stop this unhealthy practice it is felt that there should be break in their re-appointment. Therefore, it is proposed that no company shall appoint or re-appoint same auditor for more than five consecutive accounting years. However, such an auditor may be considered for appointment after the expiry of five years from the last term of appointment.

## Falsification of Accounts

5.7 A shareholder normally judge the performance of the company by looking at its accounts as disclosed at the time of General Meeting of the company. The accounts are required to present a true and fair view of the financial status of the company. There should be adequate disclosures about investments, income and expenditure etc. But the recent experience revealed at international level indicates that all is not well in preparation and presentation of accounts. The corporate sector has been found indulging in accounting juggleries resulting in overstatement of income or suppression of expenditure etc., beside adoption of many other practices to inflate profits. This all becomes possible by manipulating and doctoring accounts. The accounts, therefore, assume a paramount position when the question of a company's financial health or an assessment of its financial status comes for consideration before a shareholder or lending institution or investing company.

The credibility of accounts and those who are supposed to maintain them, audit them and present them should be above board. Any wilful default in this area has very serious implications for all those who are related to the company in any manner including the shareholder, creditors, investors or the public/society at large. Any

negligence or fraud in this area has to be taken seriously and there should be adequate penal provisions in law to reflect the seriousness of any misadventure in this area. All those connected with maintenance and auditing of accounts should, therefore, be held responsible for such lapses and punished severely. This will give a message to all those concerned that there shall be no compromise in respect of conduct as it is within one's own power. Presently, there is no separate or specific penal provision in the Companies Act, 1956 to provide for punishment for falsification of books of Accounts. It is therefore, felt that there should be provision in the Act on the lines of Section 539, which relates only to a company under winding-up process, for providing deterrent punishment for falsification of books or papers or securities in respect of a company. This would act as a deterrent on unscrupulous management which in collusion with auditors of the company or otherwise indulge in falsification of the books of accounts of the company. Such tutored/doctored accounts are beyond doubt prejudicial to interest of not only investors but also public at large as these companies on the basis of these false accounts succeed in securing funds from the financial institution or banks. It is therefore proposed that a provision be inserted in the Act providing for imprisonment of not less than one year and upto 10 years for the management and the statutory auditors of the company, if they are found to have been involved in

or engaged themselves in fraudulent accounting practices including their involvement in any manner as a direct participant or as an aider or abettor or as a co-conspirator in fraudulent acts or in omission and commission of such schemes.

### Appointment of Chief Accounts Officer

5.8 Presently, the Board of directors are responsible for maintenance of proper books of account and management of finance of the company. But there is no single officer who could be made responsible for proper maintenance and correctness of the accounts. The accounts area is becoming complicated day by day with large number of avenues/alternatives available for investments and variety of financial instruments operating in the market. It is therefore desirable that companies should have a senior professional accountant on its roll who can be entrusted with all responsibilities and legal compliances required in connection with accounts, audit and financial disclosures etc. In the event of any non-compliance or negligence in this area the officer so designated for this purpose will be held responsible and action against him could be taken as per the provisions of the law. The time is ripe now to develop a system wherein companies should have a responsible officer who could be specifically made responsible for preparation and maintenance of proper accounts and



management of finance of the company. The incumbent should be either a member of Institute of Chartered Accountants of India or that of Institute of Costs & Works Accounts of India. Such a person, who will be called Chief Accounts Officer, should be appointed only in such companies having paid up share capital of rupees five crore or more.

### **Auditors to Report Diversion of Funds**

5.9 The books of accounts of every company are statutorily required to be audited every year by an auditor. The Companies Act provides what all the statutory auditor is supposed to inquire into and the manner in which he would make a report so that it presents a true and fair view of the accounts of the company. Companies have been raising funds from various sources for its business needs in general including for certain identifiable plans or projects. The funds can be mobilised through public issues, from Financial Institutions or Banks or by inviting deposits from public etc. It is, however, noticed that sometimes companies deploy such funds for the purpose other than the purpose for which these were raised. Presently, there is no specific duty on the auditors to check and report such diversion of funds to the shareholders in their report. It is, therefore, proposed to cast a responsibility on the auditors to check and report diversion, misutilization or misappropriation of

funds by companies in the Auditors' Report by including this  
in MAOCARO.

## MANAGEMENT AND ADMINISTRATION

6.1 Sound management and efficient administration of companies is key to better corporate governance and their competitive strength. For harmonious growth, it is imperative that managerial powers ought to be exercised not merely in the interest of shareholders but also take care of other stakeholders viz. creditors, financial institutions, employees beside that of industry, public and economy as a whole. Undisputedly, an ill-managed company is beneficial to none. Of late average shareholders who are engaged in different occupations/professions are primarily keen to earn higher yield and capital appreciation on investment rather than interested in controlling the affairs of the company. Such disinclination on the part of shareholders has endangered their interest. Moreover ever-increasing size and complexities of business have made inevitable for management to induct professionals for survival and growth of companies. To overcome this difficulty, system of managing agency etc. was introduced but soon it had to be abolished as it failed to deliver the desired results. In the ever changing scenario and also in order to cope up with complexities of modern business, more and more professionals are taking up reign of senior management positions in companies which used to be previously primarily held by owner-managers.

6.2 The present perception is that a fair management and efficient administration is essential and desirable for a company in modern times. The Companies Act, 1956 devotes large number of provisions to ensure that companies are managed in a fair, transparent and efficient manner. Number of general principles have been laid down in this area, in the form of various provisions, to achieve this goal. These cover matters relating to registered office of the company and its name, commencement of business, register of members, annual returns, limit on managerial remuneration, dividend and time for payment thereof, accounts, audit, investigation etc. of companies. Other important issues which fall in this area are constitution of Board of directors, qualifications and disqualifications of directors, audit committee, remuneration of directors, compromises, arrangements and reconstruction of companies, prevention of oppression and mis-management etc.

6.3 Keeping in view above issues, certain amendments have already been made in the Companies Act during last three years. These changes include allowing companies to buy their own shares subject to certain conditions, to issue share with disproportionate rights as to dividend/voting, to issue "Sweat Equity" in lieu of intellectual property to promoters, directors and employees of companies, permitting companies to make inter-corporate investments loans without prior approval of the Central Government, mandatory

compliance of Accounting Standards in preparation of Annual Accounts, appointment of Audit Committee, providing for a Secretarial Compliance Certificate for companies of certain size, introduction of postal ballot to transact specified business, limiting the number of companies in which a person can be a director, amplification of list of disqualifications of directors, requiring Board to furnish its Responsibility Statement in its Report, etc. Thus, meaningful and upright steps have been taken in the recent past to further streamline the administration and working of companies. Nonetheless, some more changes, which are considered desirable in the present day context of need for efficient functioning of the companies, are suggested below:-

### **Professional Firms**

6.4 Sub-section (2) of section 11 of the Act stipulates that no company, association or partnership consisting of more than 20 persons can be formed for the purpose of carrying on any business for gain, unless it is registered as a company under the Companies Act, or is formed in issuance of some other Indian Law. The respective Acts governing the professions of Chartered Accountants, Cost & Works Accountants and Company Secretaries, Advocates, etc. do not allow corporate bodies to practise. Section 226(3) also specifically provides that a body corporate is

not qualified for appointment as auditor. The limit of 20 partners have thus been a hindrance in the growth of firms constituted by professionals such as Chartered Accountants, Cost Accountants, Company Secretaries, Advocates, etc. No such restriction is imposed in the contemporary laws of developed countries with the result there are several accounting and solicitors firms abroad having international presence. In the wake of GATS negotiations on professional services, Indian professionals will have to face competition from abroad under the WTO regime. The High Powered Expert Committee on Competition Policy & Law in Para 8.1.7 of its Report has also observed that India's competitiveness lies more in services rather than in manufacturing sector as India has large reservoir of technically skilled population for all levels and sectors. Thus, there is a need to evolve a law and policy, which subserve the above advantage. It is, therefore, proposed to increase the maximum number of partners from 20 to 50 in case of firms of professionals such as Chartered Accountants, Cost & Works Accountants and Company Secretaries, Advocates and such other professions which are governed, regulated and disciplined by an Act of Parliament or are notified as such by the Central Government.

## Special Notice to be Accompanied with Deposit

6.5 Companies are required to hold a general meeting of its shareholders once a year. Most of the major issues concerning the company are decided or agreed upon through passing of various resolutions at this meeting. These resolutions are basically moved by the management and then considered and approved by the shareholders. There are certain issues like appointment & removal of directors and auditors etc. on which a shareholder, if so desires, can also move a resolution for consideration at the general meeting. For this, a special notice needs to be served by the shareholder on the company within a stipulated time frame. The company is under legal obligation to circulate such resolution to all shareholders and place it for consideration at the meeting. Section 190 of the Act, therefore, provides that where, by any provision contained in the Act or in the articles, special notice is required of any resolution, notice of the intention to move the resolution shall be given by the member to the company not less than fourteen days before the meeting at which it is to be moved. In the last few years instances of this provision having been misused by some shareholders have come to notice who proposed the removal of Chairman of Board or any director or auditor without any meaningful support from the other members. To avoid non-serious proposals, it is proposed to provide for in the aforementioned Section that a

notice for such resolution would be accompanied with a deposit of Rs.10,000/- (Rupees Ten Thousand) to be made with the company. The deposit will be refunded if the resolution is carried and will be forfeited in case the resolution is not supported by at least one per cent of total number of members present and voted at the meeting.

## Public Financial Institutions

6.6 Section 4A of the Companies Act, specifies certain financial institutions to be regarded as Public Financial Institutions for the purpose of the Act. The Central Government is also empowered to specify by notification any other institution as Public Financial Institution. Under this provision, the Government has notified over 40 financial companies/institutions as PFI. Over the years, the pattern of share holding and consequent composition as well as the role of these institutions have undergone a sea change. Many of them started as fully owned Government Corporations and later have disinvested their shares in favour of other parties. The ownership and also the control mechanism in such institutions have altered considerably since they were initially constituted for specific purpose, which may not be very relevant today. Today, they have to function more like a business entity rather than as a government subsidised funding agency with social objectives only. It is thus felt that with the concept of public



financing having undergone sea change over the years, no specific purpose is being served by this section now under the Companies Act, 1956. The notified PFIs are rather using a declaration under this provision for the purpose of adjusting their tax liabilities only. Therefore, it is proposed that this section be deleted from the Companies Act.

### Advisory Committee

6.7 Section 410 of the Act provides that for the purpose of advising the Central Government and the Company Law Board on matters arising out of the administration of this Act, the Central Government may constitute an Advisory Committee. A provision of this kind was perhaps necessary some fifty years back when there was hardly any institutionalized arrangement for Government to interact with business community. Such a formal Committee provision was envisioned to provide an opportunity for Government to consult trade & industry on issues arising out of the administration of the Companies Act, 1956. However, the scenario is completely changed today. The business community is well represented in organised form through their Associations like FICCI, ASSOCHAM, CII and various Chambers of Commerce. These trade bodies/Associations now take up with Government on regular basis various issues concerning them. The Government also gives representation

to these bodies on Committees set up to debate major issues concerning industry. Seminars, Workshops, Conferences on relevant policy issues are conducted whereat Government officers and trade representatives share the same platform and deliberate on issues without constraints and inhibition. Moreover, many professional bodies such as ICAI, ICWAI & ICSI also organise various Professional Development Programmes, meetings and workshops where participants from Government, industry and professions discuss important issues. In this changed milieu, it is felt that there is hardly any need for such statutory arrangement like the one as provided under section 410 for exchange of views. As the provisions of this section have outlived their utility and consequently become redundant with changed time and style of Government functioning, it is proposed to delete this section altogether from the Act.

### **Inspection of companies by professionals**

6.8 The companies are required to comply with various provisions of the Companies Act, which in itself is a quite exhaustive piece of legislation running into more than 600 Sections and XV Schedules. Then there are large number of Rules and Regulations framed under the Act, which provide for various kinds of statutory disclosures and compliances. India has by now over half a million companies incorporated under the Companies Act. While most of them may be

following and complying statutory provisions in letter and spirit sincerely but still a large section thereof is not complying the law fully. The violations, non-compliances and disobediences of such companies can be found out only through vigorous inspections, which the Government is empowered to undertake under the provisions of the Companies Act. These inspections have, therefore, a very important role in identifying the defaulting companies and the infirmities/violations noticed and thereafter taking action against them as per law.

6.9 The existing provisions as contained in Section 209A of the Companies Act provides that the books of account and other books and papers of every company shall be open to inspection by (i) Registrar, or (ii) by such officer of the Government as authorized by the Central Government in this behalf; (iii) by such officers of Securities and Exchange Board of India as may be authorized by it. It is well known that while there has been continuous growth in the number of companies, there has not been corresponding increase in the manpower available with the Department of Company Affairs of the Govt of India on which responsibility devolves to administer the provisions of the Companies Act. The number of companies whose books of account are inspected at present every year is on an average around 250, which is minuscule of total number of companies at work. Such number of inspections hardly makes any visible impact. The number

of inspections, therefore, needs to be stepped up drastically for ensuring better compliance of the statutory provisions of the companies Act. The need for inspection has also been heightened in view of more and more self-regulatory provisions having been incorporated in the Act in the recent past. The enormous increase in complexities of law, procedures and practices of corporate bodies have made imperative for an Inspector to have expertise and specialized knowledge in varied fields including law, accountancy, finance, trade, marketing etc. Moreover, inspecting manpower need to hone their skills continuously to reveal the violations. The existing blend of Inspection Officers needs to be complimented by professionals in practice. It is, therefore, proposed that the Central Government be empowered inter-alia to notify professionals like Company Secretaries, Chartered Accountants, Cost Accountants or firms of such professionals whose services can be utilized for conducting inspection of books and records of companies under Section 209A of the Companies Act.

### **Striking off defunct companies**

6.10 Section 560 of the Act provides the procedure for striking off the name of defunct companies, which are not carrying on any business, from the register of companies maintained by the Registrar. Till recently, i.e., before

an amendment was carried out in the Companies Act in 2000 it was a very easy and inexpensive proposition for anyone to register a new company as there was no statutory requirement of minimum paid-up share capital. A new company could be registered with seven shares of rupees ten each in case of public limited company. This has resulted in registration of large number of non-serious companies, which had no intention of carrying any business activity on regular basis. These companies were used primarily for transfer of funds through uneconomic investments or loans to subsidiaries etc. Many such companies have ceased to be operative after few transactions. This process has, therefore, burdened the system with large number of defunct companies, which were neither operational nor complying with various mandatory requirements like filing of annual accounts and other returns etc. with the Registrar as provided in the Companies Act. The existing law as contained in Section 560 of Act though provides for procedure to wipe out such companies but the same has been found to be ineffective to remedy the situation quickly. Under the existing law, the Registrar first sends a letter to the company and if company does not reply, he publishes a notice in the Official Gazette. After expiry of three months from the first notice, a second notice is required to be published in the Official Gazette for striking off the name of the company from the Register. Each time a mandatory minimum period has to be given to the company to

reply. The present procedure to strike off the name of the company from the Register is therefore, cumbersome, lengthy besides being time consuming. With a view to provide a simplified exit route to the companies which are not carrying on any business or have no future plans for continuing the business, it is proposed to change the requirement of publishing the notice in the Official Gazette and instead the same be published in one English newspaper and one vernacular newspaper circulating in the area in which the registered office of the company is situated. The requirement of publishing the notice twice which prevail now is also proposed to be dispensed with. The revised procedure is expected to expedite striking off process of defunct companies by the Registrar from its register.

## Chain of Subsidiaries

6.11 Section 4 of the Companies Act, describes the conditions under which a company shall be deemed to be a subsidiary of another company. Under this provision, it is possible to create a chain of subsidiaries, which can be used by corporates for siphoning of funds. Consequently, loans and advances can be given to subsidiary companies down the chain without adequate security, sometimes with unsound financial position and at low rates of interest to the advantage of the latter and detriment of the former. Similarly improper transfer of assets of one company

to another is resorted to with the object of benefiting one to the prejudice of other. These subsidiaries are also used for the purpose of making cross investments and this is done in a chain system with the result it becomes very difficult to locate the end user of the fund. In the Group Companies, a noticeable factor is that some of the companies have public participation while smaller companies of Group do not have public participation. To avoid such pyramidal structures in the corporates, it is proposed that a company, which is subsidiary of another company, cannot become a holding company. This means only one level of subsidiary will be allowed. The only exception to this proposed amendment to be made is in case of subsidiaries of foreign companies set up in India. In this case, one more tier i.e. second level subsidiary will be allowed.

## Chapter 7

### CONCLUSIONS

7.1 Post-Independent India has witnessed a very impressive growth of the corporate sector. Over 5.8 lakhs companies with estimated paid-up capital of about Rs.339801 crores were at work in the country as on December 31,2001. This prime sector of the economy has also contributed significantly to the economic growth of the country and well being of the society. The Government has been attaching great importance to the corporate sector is evident from the frequent exercises undertaken by it to bring about refreshing changes in the way in which the corporate enterprises function by amending the Companies Act. However, the disquieting features of the corporate growth have been the increasing incidences of vanishing companies, mismanagement, widespread shareholders dissatisfaction and unethical business practices. The last decade also witnessed the unearthing of several scams considerably eroding the investors' confidence. Accordingly, the Government had initiated measures both legislative as well as ameliorative, to arrest the further deterioration in the functioning of corporate sector as also to heal the damage caused.



7.2 The future outlook for the company law is as unpredictable and complex as the emerging business environment.

7.3 Any attempt to further modify, amplify or nullify the present regulatory framework for companies - Company Law - cannot put out of consideration the expected advancements in science and technology which are changing the world at an unprecedented pace and creating new economic structures, new centres of power and wealth and new economic forces. New concepts, new tools of corporate control and in fact new ideas of business ownership are emerging. The existing concept of corporate structure of limited liability though might continue for the foreseeable future, the very foundations of this concept may undergo drastic changes. Therefore, any future regulatory transformation should encompass the other extremely important components of the economic climate. In a knowledge driven society no regulatory model can be appreciated in isolation. Accordingly, the company law has to conform to the expectations of globalisation, financial institutions, investors and all other stakeholders of the society. The litmus test will lie in the harmonization of company

law with that of global standards, the process which has been started about a decade ago.

7.4 To transplant the concept of corporate excellence through corporate governance must be the ultimate benchmark for corporates. With the opening up of the economy and to be in tune with the WTO requirements, if Indian corporates have to survive and succeed amidst increasing competition from transnational and foreign corporates, it can only be through achieving excellence in their working, excellence in terms of administration, the end product or service, investor return, social responsibilities and excellence in terms of rewards to the people who run the corporates including workers. Destination India is not confined to attracting foreigners for holidaying in India, but it is also for foreign investors for parking their funds in India and to share their know-how and technology with India in order to create wealth.

7.5 Another area which can be used in the context of better compliance of corporate legal provision is the institution of the Company Secretaries. The Company Secretaries are persons with specialised knowledge on laws relating to operations of the companies and this

knowledge can be made use for the purpose of ensuring compliance by companies. The Companies Act, 1956 not only provides for mandatory appointment of Company Secretary in large companies, the Act also stipulates for secretarial compliance report of smaller companies. This is a welcome measure brought out by a recent amendment in the Act in 2000. This compliance report is to be certified by a Company Secretary in Practice. It is just the same way in which an auditor in practice is required to comment on the financial statements of the company and give his report. It is, however, noticed that the Company Secretaries in Practice have not been provided in the Act same protection as is available to a statutory auditor with respect to his appointment, remuneration and removal. The Committee felt that it is desirable to bring Company Secretaries and Auditors on par with a view to ensure independence to secretary in whole-time practice for issuing compliance certificate to companies having paid-up share capital of not less than rupees ten lakhs and not required to appoint a whole-time secretary. The provisions relating to appointment, remuneration and removal of auditor contained in sections 224 to 226 of the Act should apply *mutatis mutandis* to the appointment, remuneration and removal of Company Secretary in whole-time practice

under section 383A. In line with the perception on reappointment of same auditor, the same Company Secretary in Practice shall not be reappointed for more than five consecutive accounting years and he shall, however, be eligible for appointment as such after expiry of five years from the end of his last term.

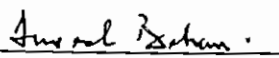
7.6 Within the given parameters, the Committee discussed and analysed the provisions of the Companies Bill, 1997 to arrive at certain recommendations, considering the developments that have taken place the world over since the said Bill was introduced in the Parliament. A summary of these recommendations, which could form legislative proposals for amendments in the Companies Act, 1956 has been tabulated and indicated in Appendix-II. The Committee also recommend that the Govt. may now consider withdrawing the Companies Bill, 1997 from the Parliament as some of the provisions of this Bill have already been enacted through the Amendment Acts passed in 1999 and 2000 and with implementation of the recommendations of this Committee by moving further amendments in the Act, nothing important which needs to be brought into force immediately in the interest of better corporate functioning, will be left in the said Bill.

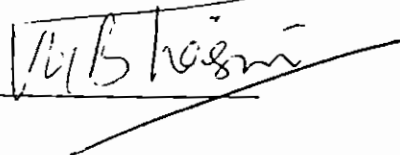
Nonetheless an overall exercise to have yet another look with an open mind at the Companies Act, 1956 would be desirable primarily from the point of view of consolidating the large number of amendments already made in Act since its enactment and also with a view to examine whether the Companies Act, 1956 can be divided into 2 or 3 smaller compact independent Acts. In this context, the Committee was of the view that there is a need now for giving focused attention to the smaller companies which constitute over 90% of the companies and constitute a major component of the economy and a separate law could be enacted to deal with such companies wherein Government's direct intervention should be minimized. For the public limited and listed companies there may be another law wherein the emphasis should be on higher disclosures, transparency, accountability and responsibility towards investors etc. The Government's intervention in respect of these companies should be higher with the help of a strong monitoring and regulatory framework. Similarly, existing provisions in the Companies Act, 1956 relating to winding up, compromises, arrangements and reconstructions could be taken out and enacted as separate law governing the procedure relating to insolvency of corporates. The Companies Act, 1956,

which is very comprehensive legislation with more than six hundred sections and XV Schedules, can therefore be divided rationally into three separate statutes to meet the specific requirements of each area. The Committee, therefore, recommends that the Government may consider this aspect.

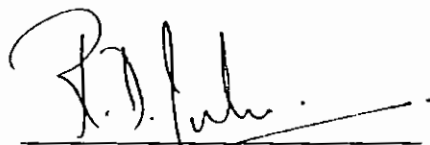
7.7 Finally before concluding the Committee would like to express its appreciation for the valuable support extended by Shri V.K. Aggarwal, Senior Director, ICSI during deliberations of the Committee and in drafting of the Report. The Committee would also like to place on record its appreciation and gratitude to Shri G.R.Bhatia, Additional Director General (Inv. & Reg.) for going through the draft report and making many useful suggestions for improvement in the content and presentation of the Report.

  
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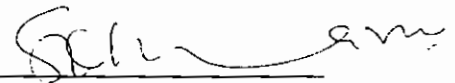
  
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Dated: 25<sup>th</sup> September, 2002  
Place: New Delhi

# **APPENDICES**

APPENDIX-I

No.11/3/2002-CL.V  
Government of India  
Ministry of Law, Justice & Company Affairs  
Department of Company Affairs  
Dated: 4<sup>th</sup> April, 2002

O R D E R

The Central Government hereby constitutes a Committee consisting of the following officials to examine the remaining provisions of the Companies (Amendment) Bill, 1997 and any other matter with the permission of the Chair and submit its report with its recommendations within a period of one month.

- |    |   |                    |
|----|---|--------------------|
| 1. | R D Joshi,<br>Director General (I & R)          | Chairman           |
| 2. | Rajiv Mehrishi,<br>Joint Secretary, DCA         | Alternate Chairman |
| 3. | V K Bhasin,<br>Joint Secretary, Ministry of Law | Member             |
| 4. | S B Mathur,<br>DII (Retd.)                      | Member             |
| 5. | Ashok Haldia,<br>Secretary, ICAI                | Member             |
| 6. | S P Narang,<br>Secretary, ICSI                  | Member             |
| 7. | E Selvaraj,<br>JD(T), DCA                       | Member             |
| 8. | S K Sharma,<br>AD (I), DCA                      | Member             |
| 9. | S P Dixit,<br>JD (L), DCA                       | Member Secretary   |

Sd/-  
(Thakur Sharan)  
Under Secretary to the Government of India

To

1. All Members of the Committee
2. Sr. PPS to Secretary
3. P.S. to Minister of Law, Justice & Co. Affairs
4. All Officers & Sections in the Department.



## APPENDIX-II

### AMENDMENTS PROPOSED IN THE COMPANIES ACT, 1956

Sl. No.	Section of the Companies Act	Text of the Section	Proposed Amendment	Reasons for Change
(1)	(2)	(3)	(4)	(5)
1.	2	Definition of Chief Accounts Officer- New Section	"Chief Accounts Officer" means the chief accounts officer of a company appointed under section----- --by whatever name called.	To prescribe the definition of "Chief Accounts Officer" is necessary as this post is being created for first time in the Act and this designation will appear in more than one section in the Act.
2.	2(15A)	"employees stock option" means the option given to the whole time directors, officers or employees of a company, which gives such directors, officers or employees the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a pre determined price.	To delete this definition.	No scheme for "Employees Stock Option" has been provided in the Act. Therefore, definition of this concept has become redundant and consequently needs to be deleted.
3.	2(45)	"secretary" means a Company Secretary within the meaning of clause (c) of sub-section (1) of Section 2 of the Companies Secretaries Act, 1980 (56 of 1980) and includes any other individual possessing the prescribed qualifications and appointed to perform the duties which may be performed by a secretary under this Act and any other ministerial or administrative duties.	It is proposed to modify this definition. The words "any other ministerial or administrative duties" be modified to read as "any other managerial and administrative functions."	This change in definition is required to reflect the job profile which Company Secretaries are now required to perform in the Companies. This is also in line with the suggestion made by the Standing Committee.
4.	4	Meaning of "holding company" and "subsidiary"-(1) For the purposes of this Act, a company shall, subject to the provisions of sub-section (3), be deemed to	It is to provided that no company which is a subsidiary of another company shall, after the commencement of this Act, be a holding company. This restriction will however	It is desirable to put some control on unending chain of subsidiaries which are set up by big companies/corporate houses as these are being used as investment

(1)	(2)	(3)	(4)	(5)
		<p>be a subsidiary of another if, but only if,-</p> <p>(a) that other controls the composition of its Board of directors; or</p> <p>(b) that other-</p> <p>(i) where the first-mentioned company is an existing company in respect of which the holders of preference shares issued before the commencement of this Act have the same voting rights in all respects as the holders of equity shares, exercises or controls more than half of the total voting power of such company;</p> <p>(ii) where the first mentioned-company is any other company holds more than half in nominal value of its equity share capital; or</p> <p>(c) the first mentioned company is a subsidiary of any company which is that other's subsidiary.</p>	<p>be relaxed to provide for one more tier of subsidiary in case of a subsidiary of a foreign company operating in India.</p>	<p>vehicles for the purpose of siphoning of funds or manipulating the tax liability. Such a restriction is also called for in the context of diversion of funds by some unscrupulous management. As such it is becoming ultimately very difficult to trace the final recipient or end user of such money.</p> <p>One more tier of subsidiary, however, in case of a subsidiary of a foreign company operating in India shall give necessary flexibility to such companies.</p>
5.	4A	<p><b>Public Financial Institutions-</b></p> <p>(1) Each of the financial institutions specified in this sub-section shall be regarded, for the purposes of this Act, as a public financial institution, namely:-</p> <p>(i) the Industrial Credit and Investment Corporation of India Ltd.,</p> <p>(ii) the Industrial Finance Corporation of India;</p> <p>(iii) the Industrial Development Bank of India;</p> <p>(iv) the Life Insurance Corporation of India;</p>	To be deleted.	<p>No specific purpose is now being served by this provision in the Act. The very character of such Financial Institutions has undergone a considerable change in terms of their management structure, ownership and approach in service to the public in general.</p> <p>Inclusion or a declaration under this provision has been used by such companies more as a tax planning device rather than for their better working. Hence, this provision needs to be deleted for having become redundant.</p>

(1)	(2)	(3)	(4)	(5)
		<p>(v) the Unit Trust of India;</p> <p>(vi) the Infrastructure Development Finance Company Ltd.</p> <p>(2) Subject to the provisions of sub-section (1), the Central Government may, by notification in the Official Gazette, specify such other institution as it may think fit to be a public financial institution:</p> <p>Provided that no institution shall be so specified unless-</p> <p>i) it has been established or constituted by or under any Central Act, or</p> <p>ii) not less than fifty one per cent of the paid-up share capital of such institution is held or controlled by the Central Government.</p>		
6.	5	<p><b>Meaning of "officer who is in default"-</b></p> <p>For the purpose of any provision in this Act which enacts that an officer of the company who is in default shall be liable to any punishment or penalty, whether by way of imprisonment, fine or otherwise, the expression "officer who is in default" means all the following officers of the company, namely:-</p> <p>(a) the managing director or managing directors;</p> <p>(b) the whole-time director</p>	<p>The following are to be included in the existing list of officers in default:-</p> <p>i) any other director including part-time director, non-executive director and nominee director in respect of a contravention of any of the provisions of this Act, which had taken place with his consent or connivance or is attributable to any neglect on his part.</p> <p>ii) the Chief Accounts Officer.</p>	<p>In the interest of better working of the companies as well as in order to ensure a better corporate governance, it is essential that all those who play vital role in decision making process or entrusted with specific responsibility for lapses/defaults occurring in the working of the companies are also brought within the ambit of "officer who is in default". For same reasons, the Chief Accounts Officer also needs to be included in the list of officers in default.</p>

(1)	(2)	(3)	(4)	(5)
		<p>or whole-time directors;</p> <p>(c) the manager;</p> <p>(d) the secretary;</p> <p>(e) any person in accordance with whose directions or instructions the Board of directors of the company is accustomed to act;</p> <p>(f) any person charged by the Board with the responsibility of complying with that provision. Provided that the person so charged has given his consent in this behalf to the Board;</p> <p>(g) where any company does not have any of the officers specified in clauses (a) to (c), any director or directors who may be specified by the Board in this behalf or where no director is so specified, all the directors:</p>		
7.	11(2)	<p><b>Prohibition of associations and partnerships exceeding certain number:-</b> No company, association or partnership consisting of more than twenty persons shall be formed for the purpose of carrying on any other business that has for its object the acquisition of gain by the company, association or partnership, or by the individual members thereof, unless it is registered as a company under this Act, or is formed in pursuance of some other Indian law.</p>	<p>The maximum allowed number of persons to form the association shall be 50 instead of 20 in case of professionals.</p>	<p>This will enable professional like Architect, Advocate, Chartered Accountant, Cost Accountant, Company Secretary etc. to constitute a partnership firm or association with maximum up-to 50 members. Internationally, there is no such restriction as to the maximum number of partners in case of firms of professionals. It will also help Indian professionals to compete with international firms in their respective fields and will enable them to have international presence.</p>

(1)	(2)	(3)	(4)	(5)
8.	15	<p><b>Printing and signature of Memorandum.</b> The Memorandum shall –</p> <p>(a) be printed,</p> <p>(b) be divided into paragraphs numbered consecutively, and</p> <p>(c) be signed by each subscriber (who shall add his address, description and occupation, if any), in the presence of at least one witness who shall attest the signature and shall likewise add his address, description and occupation, if any.</p>	<p>It is to be provided that the subscriber shall produce to Registrar a proof of identity by providing a copy of a passport, election commission's identity card, Permanent Account Number (PAN) etc.</p>	<p>During last few years, it is noticed that many companies, including their subscribers and directors, have disappeared/eloped after collecting huge funds from the public. The investing public have thus been cheated/deceived by such unscrupulous promoters. The verification of the background and identity of subscribers who come forward to register a company is, therefore, desirable so that in the event of any unwarranted situation/ mishap such subscribers can be traced, booked and punished.</p>
9.	51	<p><b>Service of documents on company-</b> A document may be served on a company or an officer thereof by sending it to the company or officer at the registered office of the company by post under a certificate of posting or by registered post, or by leaving it at its registered office:</p>	<p>So as to make it electronically friendly service of documents can be by such other means as may be prescribed.</p>	<p>Many new modes of communication like E-mail, FAX courier service, Speed post have now become available which are much faster. It is desirable that these are also recognized as legal mode of service for the purposes of Companies Act.</p>
10.	52	<p><b>Service of documents on Registrar-</b> A document may be served on a Registrar by sending it to him at his office by post under a certificate of posting or by registered post, or by delivering it to, or leaving it for, him at his office.</p>	<p>So as to make it electronically friendly service of documents can be by such other means as may be prescribed.</p>	<p>Many new modes of communication like E-mail, Fax, courier service. Speed post have now become available which are much faster. It is desirable that these are also recognized as legal mode of service for the purposes of the Companies Act.</p>
11.	53	<p><b>Service of documents on members by company –</b></p> <p>(1) A document may be served by a company on any member thereof either personally, or by sending it</p>	<p>So as to make it electronically friendly service of documents can be by such other means as may be prescribed.</p>	<p>Many new modes of communication like E-mail, Fax, Courier service. Speed post have now become available which are much faster. It is</p>

(1)	(2)	(3)	(4)	(5)
		<p>by post to him to his registered address, or if he has no registered address in India, to the address, if any, within India, supplied by him to the company for the giving of notices to him.</p> <p>(2) Where a document is sent by post, -</p> <p>(a) service thereof shall be deemed to be effected by properly addressing, prepaying and posting a letter containing the document, provided that where a member has intimated to the company in advance that documents should be sent to him under a certificate of posting or by registered post with or without acknowledgment due and has deposited with the company a sum sufficient to defray the expenses of doing so, service of the document shall not be deemed to be effected unless it is sent in the manner intimated by the member; and</p> <p>(b) such service shall be deemed to have been effected-</p> <p>(i) in the case of a notice of meeting, at the expiration of forty eight hours after the letter containing the same is posted; and</p> <p>(ii) in any other case, at the time at which the letter would be delivered in the ordinary course of post.</p>		<p>desirable that these are also recognized as legal mode of service for the purposes of the Companies Act.</p>

(1)	(2)	(3)	(4)	(5)
12.	69(5)	<p><b>Prohibition of allotment unless minimum subscription received</b> – If the conditions aforesaid have not been complied with on the expiry of one hundred and twenty days after the first issue of the prospectus, all moneys received from applicants for shares shall be forthwith repaid to them without interest; and if any such money is not so repaid within one hundred and thirty days after the issue of the prospectus, the directors of the company shall be jointly and severally liable to repay that money with interest at the rate of six per cent per annum from the expiry of the one hundred and thirtieth day :</p>	<p>It is to be provided that if the company does not repay application money within 130 days after issue of prospectus the director of the company shall be jointly and severally liable to repay application money with interest at the rate of not less than fifteen percent per annum.</p>	<p>After a company invites public to subscribe to a public issue, the company has to issue shares within a stipulated time and return the subscription money to those who have not been allotted shares. Presently, if the company fails to return the application money within 130 days it has to pay back the same alongwith 6% interest to the applicant. This rate is considered too low and may act as an incentive for company to retain the money. To discourage the company not to resort to such delay it is proposed to enhance the rate of interest on the delayed refund of money to such applicant @ not less than 15% per annum.</p>
13.	72	<p><b>Applications for, and allotment of shares and debentures - New sub-section.</b></p>	<p>It is to be provided that promoters or directors or relatives of associates of such promoters or directors who have applied in pursuance of a prospectus shall not be entitled to revoke once having made their application for shares or debentures.</p>	<p>This is necessary to curb an undesirable practice wherein the promoters/directors and their relatives and associates revoke application for shares subsequently and the general public which has applied for shares in response to a prospectus are duped or left with no alternative, but to stick to investment they have already made.</p>
14.	108A to 108-I	<p><b>Restriction on acquisition of certain shares.</b></p>	<p>It is proposed to delete these sections as these have become irrelevant now in the absence of any control on creation of monopolies.</p>	<p>These Sections were originally enacted to regulate the acquisition and transfer of shares of companies to which provisions of Chapter III of MRTTP Act, 1969 was applicable. These were then called MRTTP Undertakings. These sections were thus intended to prevent acquisition or</p>

(1)	(2)	(3)	(4)	(5)
				<p>takeover of companies leading to further concentration of economic powers. This situation has, however, now drastically changed in 1991 when MRTP Act, 1969 was amended to delete the provisions requiring pre-entry restrictions for expansion, establishment of new undertaking merger, amalgamation, take over etc. Section 108A to 108-I were also transferred in the year 1991 from MRTP Act, 1969 to the Companies Act, 1956 by the amendment carried out in MRTP Act, 1969. These sections have now become redundant and are therefore proposed to be deleted.</p>
15.	173	<p><b>Explanatory statement to be annexed to Notice.</b>  <b>(2)</b> Where any items of business to be transacted at the meeting are deemed to be special as aforesaid, there shall be annexed to the notice of the meeting a statement setting out all material facts concerning each such item of business, including in particular the nature of the concern or interest, if any therein, of every director, and the manager, if any:</p> <p>Provided that where any item of special business as aforesaid to be transacted at a meeting of the company relates to, or affects, any other company, the extent of shareholding interest in that other company of every director and the manager, if any, of the first-mentioned company</p>	<p>It is proposed to provide that the explanatory statement to be annexed to notice of a meeting in respect of a special business shall inter-alia require a company to disclose concern or interest which a relative of a every director or Manager has in the special business. It is also proposed to provide that a company shall also be required to give particulars of shareholding interest of the director's relative in that other company.</p> <p>It is also proposed to cast a liability on director/manager for non-disclosure or insufficient disclosure, to hold in trust, the benefits received by him, directly or indirectly and to compensate/reimburse the company. It is also proposed to strengthen the</p>	<p>Under the existing law, the explanatory statement annexed to the notice of a meeting where at special business is to be transacted is required to disclose interest/concern of Director/Manager. There is no requirement to disclose the concern or interest which a relative of a director has in the special business. In the interest of proper governance, it is desirable to strengthen the disclosure requirement by providing that information relating to director's relative including shareholding interest in another company shall be disclosed in the explanatory statement. It is also necessary to provide for liability on a director/Manager to hold in trust the benefit derived by non-disclosure or</p>



(1)	(2)	(3)	(4)	(5)
16.	190	<p>shall also be set out in the statement if the extent of such shareholding interest is not less than twenty per cent of the paid-up share capital of that other company.</p> <p><b>Resolutions requiring special notice –(1)</b> Where, by any provision contained in this Act or in the articles, special notice is required of any resolution, notice of the intention to move the resolution shall be given to the company not less than fourteen days before the meeting at which it is to be moved, exclusive of the day on which the notice is served or deemed to be served and the day of the meeting.</p>	<p>penal provisions by providing imprisonment for a term, which shall not be for a term less than six months but may extend to five years and fine which shall not be less than Rs.50,000/-.</p> <p>A proviso to be added that a person desiring to move a special resolution should deposit rupees ten thousand with the company, which will be refunded if the resolutions is passed. The deposit shall be forfeited if the resolution is not supported by at least one per cent of total number of votes cast on that resolution.</p>	<p>inadequate disclosure. To make it deterrent, it is inevitable to strengthen considerably the penal provisions.</p> <p>Some shareholders misuse this provision by moving resolution without any meaningful support of other members. This is done more in order to harass the management rather than effecting any genuine change. Prescription of a deposit will discourage such members to move non-serious or frivolous resolution and thus save the energy, efforts and time of company at AGM.</p>
17.	205	<p><b>Dividend to be paid only out of profits.</b> New sub-section</p>	<p>It is now proposed that no company shall give or no shareholder (including any proxy holder) shall demand or accept any gift either in cash or kind at any general meeting. For this purpose, gift would not include any discount coupon or any food or beverages offered at any general meeting by the company to the shareholders.</p>	<p>It is noticed that sometimes some shareholders insist at the time of AGM that they should be given gifts by the company. If this is not complied those irresponsible shareholders try to disturb the proceedings of the AGM. Absence of specific prohibition also give leverage to unscrupulous promoters/ directors to use this method to get their resolution passed. In order to prevent these malpractices it is appropriate to prohibit distribution of gifts at general meetings of shareholders.</p>
18.	205A	<p><b>Unpaid dividend to be transferred to special dividend account.</b> New Sub-Section.</p>	<p>It is proposed to provide that a company shall give notice every year to every shareholder who has not been paid or has not</p>	<p>It may happen that dividend warrant does not reach the shareholder for reasons such as change of address or loss of it during</p>

(1)	(2)	(3)	(4)	(5)
			<p>claimed dividend stating therein the amount of dividend he is entitled to claim till the amount is transferred to the Investor Education and Protection Fund.</p>	<p>transit or due to any other factor. Such shareholder is thereby deprived of information that he is entitled to a dividend. To ensure that he gets information and thereby enabling him to receive unpaid/unclaimed dividend, a responsibility is being cast on the company to inform him of his dues every year alongwith the notice of AGM.</p>
19.	209A(1)	<p><b>Inspection of books of account etc. of companies.</b> The books of account and other books and papers of every company shall be open for inspection during business hours-</p> <p>(i) by the Registrar;</p> <p>(ii) by such officer of the Govt. as may be authorized by the Central Govt. in this behalf;</p> <p>(iii) by such officer of the Securities and Exchange Board of India as may be authorized by it:</p>	<p>It is proposed to confer inter-alia a power in the Central Government to appoint professionals in practice to undertake inspection of books of account and other books and papers of every company.</p>	<p>The enormous increase in number of companies, limited manpower with the Department, heightened need to step up inspection in the wake of insertion of many self regulatory provisions, enhancement of complexities of corporate practices have made it imperative that the existing blend of inspection machinery be complemented by professionals in practice.</p>
20.	212	<p><b>Balance Sheet of holding company to include certain particulars as to its subsidiaries.</b>(1) There shall be attached to the balance-sheet of a holding company having a subsidiary or subsidiaries at the end of the financial year as at which the holding company's balance sheet is made out, the following documents in respect of such subsidiary or of each such subsidiary, as the case may be:-</p> <p>(a) a copy of the balance sheet of the subsidiary;</p> <p>(b) a copy of its profit and</p>	<p>Companies which prepare group accounts will be exempted from the provisions of this section* to attach balance sheet of its subsidiary.</p>	<p>Since the concept of preparation of consolidated accounts in respect of all subsidiaries is being introduced, it is felt that the requirement to attach the balance sheet of the subsidiary alongwith the annual accounts of the holding company is unnecessary and is, therefore, proposed to be dispensed with.</p>

(1)	(2)	(3)	(4)	(5)
		loss account; (c) a copy of the report of its Board of directors; (d) a copy of the report of its auditors; (e) a statement of the holding company's interest in the subsidiary as specified in sub-section (3); (f) the statement referred to in sub-section (5), if any; and (g) the report referred to in sub-section (6), if any.		
21.	New Section	<b>Consolidated Accounts.</b>	Where a company is a holding company and has one or more subsidiaries it will be required to prepare consolidated accounts for itself and for all of its subsidiaries.	Consolidation of Accounts within the Group is an internationally established practice. This will help investors to get first hand information about the Group as a whole for taking informed decision for investment. This will also help financial/lending Institutions/banks to take decision for financing/ investment etc.
22.	New Section	<b>Chief Accounts Officer</b>	It is proposed to provide that every company which has a paid-up capital of Rs 5 crores or more to appoint a full time Chief Accounts Officer who will be a member of either Institute of Chartered Accountants of India or Institute of Cost & Works Accountants of India.	It is felt necessary to appoint an independent Officer in the company having a prescribed qualification who will be responsible exclusively for the preparation and maintenance of books of accounts, to ensure compliance of disclosures of required information in the Prospectus or any other documents apart from ensuring compliance of provisions of the Act relating to the accounts.
23.	220(1)	<b>Three copies of balance sheet etc., to be filed with Registrar.</b> (a) three copies of the balance sheet and the profit and loss account, signed by the managing director,	In order to reduce the work of Registrar it is proposed that the company shall file only one copy of Balance Sheet with the Registrar. The other two copies shall be sent by the company	With ever increasing number of registered companies with the offices of ROCs and consequent increase in the workload, the Registrars have not been able to send the

(1)	(2)	(3)	(4)	(5)
		<p>manager or secretary of the company, or if there be none of these, by a director of the company, together with three copies of all documents which are required by this Act to be annexed or attached to such balance sheet or profit and loss account:</p> <p>Provided that in the case of a private company, copies of the balance sheet and copies of the profit and loss account shall be filed with the Registrar separately.</p>	<p>directly to:-</p> <p>(i) Research and Statistics Division of the Department of Company Affairs; and</p> <p>(ii) the Reserve Bank of India.</p>	<p>Balance Sheets received from companies to the RBI and R&amp;S Division well in time. The purpose of calling these reports is thus defeated. In order to ensure that they get these documents it is necessary to provide legally for their direct transmission to concerned authorities by the company. This measure will also eliminate the delays, if any, caused in transmission of Reports by the Registrars to these Authorities.</p>
24.	224(1)	<p><b>Appointment and remuneration of auditors.</b> - Every company shall, at each annual general meeting, appoint an auditor or auditors to hold office from the conclusion of that meeting until the conclusion of the next annual general meeting and shall, within seven days of the appointment, give intimation thereof to every auditor so appointed.</p>	<p>It is proposed to provide that no company shall appoint or re-appoint same auditor for more than five consecutive accounting years. This will however not disqualify an auditor from being considered by company for appointment as an auditor after the expiry of five years from the end of his last term as auditor.</p>	<p>The rotation of auditors is considered necessary in order to discourage developing of a nexus between an auditor and the management of the company. This measure will reduce many irregularities, which occur due to non-reporting/mis-reporting in the accounts.</p>
25.	New Section	<p><b>Falsification of Accounts and Fraudulent Accounting Practices.</b></p> <p>- New Section</p>	<p>It is proposed to introduce a new section, which will make falsification of Accounts and Fraudulent Accounting Practices a serious offence. This will apply to Management as well as to statutory auditors of the company if they are found, with intent to defraud or deceive, involved in act:-</p> <p>(i) to destroy, mutilate, alter, falsify or are privy to destruction, mutilation, alteration, falsification of any books of accounts, papers or documents;</p>	<p>The accounts need to reflect actual state of affairs of a company in financial terms. A proper audit of its accounts, therefore, assumes paramount significance and casts an important responsibility on auditor to carry out the audit in such a way that the accounts give a true and fair view of company's affairs but this does not happen all the time. A number of accounting frauds involving internationally reputed accounting firms have recently surfaced</p>

(1)	(2)	(3)	(4)	(5)
			<p>(ii) to make or are privy to the making of, any false or fraudulent entry in any register, books of account or documents;</p> <p>(iii) to engage themselves in fraudulent accounting practices including their involvement in any manner as direct participants or as an aider and abettor or as co-conspirator in any fraudulent act.</p> <p>It is proposed to prescribe that such a default will be punishable with imprisonment for a term which will not be less than one year and not more than seven years and also liable to fine.</p>	<p>world-wide necessitating the need for more stringent rules and punishments for those indulging in such malpractices.</p> <p>At present there is no specific provision in the Act to pinpoint responsibility on management or auditor who are found involved in falsification of accounts or indulging in fraudulent accounting practices. It is, therefore, high time that a specific provision is introduced in the Act in this regard so that such violations become identifiable without any ambiguity and those found indulging in them are punished severely.</p>
26.	252(1)	<b>Minimum number of Directors.</b> - Every public company (other than a public company which has become such by virtue of section 43A) shall have at least three directors:	It is proposed to prescribe maximum number of directors as 15 and 12 in case of public and private limited companies respectively.	At present no maximum number of directors which a company can appoint, has been prescribed. This has resulted in many companies having more than 15 directors. It is desirable to place a restriction in this behalf so that the Board of directors remains compact and effective.
27.	259	<b>Increase in number of directors to require Government sanction.</b>	This section which deals with power of Central Government to increase number of directors beyond limit prescribed is proposed to be omitted.	Since the maximum number of directors which a company can appoint is now being legally provided by amending section 252, there is no need to retain with Government, the power to further increase this number by specific sanction.
28.	New Section	<b>Retiring age of directors - New Section</b>	It is proposed to provide that the maximum age to hold the office of managing	The position of managing director, whole-time director etc., is a strategic

(1)	(2)	(3)	(4)	(5)
			<p>director, whole-time director or other director or manager of the company should be seventy-five years. The existing incumbent who attains the age of 75 years after the amendment shall, however, be allowed to continue until expiry of his term. The ceiling in respect of age of a director will, however, not apply to a private company unless it is subsidiary of a public limited company.</p>	<p>position requiring not only experience, skills but also healthy physical and mental conditions. He should be in a position to handle the complex business problems and his health should permit him devoting required time to handle issue the senior position requires. Hence, prescribing a maximum age limit is considered in the interest of company and better corporate governance. Such ceiling on age of a director exists in laws of other developed countries.</p>
29.	292(1)	<p><b>Certain powers to be exercised by Board only at meeting.</b> The Board of directors of a company shall exercise the following powers on behalf of the company, and it shall do so only by means of resolutions passed at meetings of the Board:- (a) the power to make calls on shareholders in respect of money unpaid on their shares; (b) the power to issue debentures; (c) the power to borrow moneys otherwise than on debentures; (d) the power to invest the funds of the company; and (e) the power to make loans:</p>	<p>It is proposed that following powers should also be exercised by Board only at meeting:- (f) the power to issue securities, whether issued in India or outside; (g) the power to approve the balance sheet, the profit and loss account and the Board's Report, or wherever required, half yearly accounts; (h) the power to diversify the business of the company; (i) the power to approve amalgamation or merger; or reconstruction. (j) The power to takeover a company; (k) The power to make contributions to charitable or other funds; and (l) The power to buy back securities.</p>	<p>There are already certain items which need to be approved by the Board of directors only at a meeting. It is now proposed to enlarge this list by adding few more items which are considered vital from the point of view of company's working. These measures will bring more transparency and ensure more focussed discussion on important items, which ultimately will result in better corporate governance.</p>
30.	292A(10)	<p><b>Audit Committee</b> The chairman of the Audit Committee shall attend the annual general meetings of the company to provide</p>	<p>It is proposed to provide that in the event of chairman's inability to attend the annual general Meeting, the Audit</p>	<p>Under the existing law, there is no provision for alternative arrangement in the event of chairman's inability to attend the</p>

(1)	(2)	(3)	(4)	(5)
		any clarification on matters relating to audit.	Committee shall authorize one of its members to attend the annual general meeting in place of Chairman	annual general meeting. This deficiency needs to be removed and Audit Committee should be authorized to nominate one of its members to attend the annual general meeting in the event of inability of chairman to do so.
31.	294	<p><b>Appointment of sole selling agents to require approval of company in general meeting.</b></p> <p>(1) No company shall, after the commencement of the Companies (Amendment) Act, 1960, appoint a sole selling agent for any area for a term exceeding five years at a time:</p> <p>Provided that nothing in this sub-section shall be deemed to prohibit the re-appointment, or the extension of the term of office, of any sole selling agent by further periods not exceeding five years on each occasion.</p> <p>(2) After the commencement of the Companies (Amendment) Act, 1960, the Board of directors of a company shall not appoint a sole selling agent for any area except subject to the condition that the appointment shall cease to be valid if it is not approved by the company in the first general meeting held after the date on which the appointment is made.</p>	The present system envisages that sole selling agents can be appointed by the Board of directors which should be approved in the first general meeting held after the date of such appointment. It is now being proposed that sole selling agents can be appointed by the company only with previous approval obtained through a special resolution passed in general meeting. Information in this regard shall be disclosed by the Board in its report. The restriction of 5 years at a time for such appointment is also being removed.	The sole selling agents play a crucial role in marketing the products of a company. It is in the interest of the company that a right person is selected for this purpose. To bring transparency in the procedure it is desirable that such appointments are made with the previous approval of the shareholder rather than leaving it to be decided by the Board of directors and it is also disclosed in the Board's report at the general meeting.
32.	294 AA	<b>Power of Central Government to prohibit the appointment of sole selling agents in certain</b>	It is proposed to omit the existing provision, which require Government to notify list of such goods in	To appoint a sole selling agent or not and who should be appointed is a business decision which

(1)	(2)	(3)	(4)	(5)
		<p><b>cases.</b></p> <p>(1) Where the Central Government is of opinion that the demand for goods of any category, to be specified by that Government, is substantially in excess of the production or supply of such goods and that the services of sole selling agents will not be necessary to create a market for such goods, the Central Government may, by notification in the Official Gazette, declare that sole selling agents shall not be appointed by a company for the sale of such goods for such period as may be specified in the declaration.</p> <p>(2) No company shall appoint any individual, firm or body corporate, who or which has a substantial interest in the company, as sole selling agent of that company unless such appointment has been previously approved by the Central Government.</p>	<p>respect of which sole selling agents cannot be appointed by companies.</p>	<p>should be left to the company. Whether the company need such an arrangement will depend on number of external and internal factors and the management of the company is in the right position to make a judgment which is commercially best in its interest. In the regime of deregulation, it is appropriate to divest the Government of power to notify prohibition of appointment of sole selling agents by companies for such goods and for such period. It is felt that whether a person is the right choice for appointment as sole selling agent or not could be appropriately decided by the shareholders at the time of passing special resolution at general meeting for his appointment while deciding this they ought to look into all aspects including his interest in the company. So Government's approval in such cases is considered unnecessary.</p>
33.	297	<p><b>Board's sanction to be required for certain contracts in which particular directors are interested.</b></p> <p>Proviso to 297(1)</p> <p><b>"Provided that in case of a company having a paid-up share capital of not less than rupees one crore, no such contract shall be entered into except with the previous approval of the Central Government."</b></p>	<p>Proviso to section 297(1) is proposed to be omitted.</p> <p>Amount specified in sections 297(2)(b) and 297(3) is proposed to be increased to Rs. 5,00,000/- from Rs.5,000/-</p>	<p>Presently approval of the Central Govt. is required to be obtained by such companies whose paid-up share capital is not less than Rs.1 crore whenever they wish to enter into contracts where directors or their relatives are interested. This provision is now being removed. Instead, Board's approval will be sufficient for this propose. Further, the value of contracts beyond which Govt. permission is required is being raised</p>



(1)	(2)	(3)	(4)	(5)
		<p>Proviso to 297(2)(b) – <b>Provided</b> that such contract or contracts do not relate to goods and materials the value of which or services the cost of which, exceeds five thousand rupees in the aggregate in any year comprised in the period of the contract or contracts; or</p> <p>297(3) –Notwithstanding anything contained in sub-sections (1) and (2), a director, relative, firm, partner or a private company as aforesaid may, in circumstances of urgent necessity, enter, without obtaining the consent of the Board, into any contract with the company for the sale, purchase or supply of any goods, materials or services even if the value of such goods or cost of such services exceeds five thousand rupees in the aggregate in any year comprised in the period of the contract; but in such a case, the consent of the Board shall be obtained at a meeting within three months of the date on which the contract was entered into.</p>		<p>from existing Rs.5,000/- to Rs. 5 lakhs in the aggregate in a year.</p>
34.	301(3A)	<p><b>Register of contracts, companies and firms in which directors are interested.</b></p> <p>Nothing in sub-sections (1), (2) and (3) shall apply.-</p> <p>(a) to any contract or arrangement for the sale, purchase or supply of any goods, materials or services if the value of such</p>	<p>The value of goods in a contract to be entered in Register is proposed to be enhanced from Rs.1,000/- to Rs.10,000/-</p>	<p>This increase is considered necessary in the present day context of the cost. This will also reduce the need for checking record of contracts involving value less than Rs.10,000/-.</p>

(1)	(2)	(3)	(4)	(5)
		<p>goods and materials or the cost of such services does not exceed one thousand rupees in the aggregate in any year; or</p> <p>(b) to any contract or arrangement (to which section 297 or, as the case may be, section 299 applies) by a banking company for the collection of bills in the ordinary course of its business or to any transaction referred to in clause (c) of sub-section (2) of Section 297.</p>		
35.	314	<p><b>Director, etc., not hold office or place of profit.</b>  (1B) Notwithstanding anything contained in sub-section, (1) –</p> <p>(a) no partner or relative of a director or manager,</p> <p>(b) no firm in which such director or manager, or relative of either, is a partner,</p> <p>(c) no private company of which such a director or manager, or relative of either, is a director or member,</p> <p>shall hold any office or place of profit in the company which carries a total monthly remuneration of not less than such sum as may be prescribed except with the prior consent of the company by a special resolution and the approval of the Central Govt.</p>	<p>Requirement of obtaining approval of the Central Government for holding office or place of profit by relative of a director is proposed to be done away with and it shall be sufficient if special resolution is passed at a general meeting held for the first time after holding of office or place of profit by a relative. Provision of this clause shall not, however, apply to a private company unless it is a subsidiary of a public company.</p>	<p>Govt. approval for such routine matter is not considered necessary. Presently for any appointment beyond Rs.20,000/- a month, the company has to take Central Govt. approval. This will not be necessary in view of the change proposed.</p>

(1)	(2)	(3)	(4)	(5)
36	383A	<p><b>Certain companies to have secretaries</b>  <b>New proviso to sub-section (1)</b></p>	<p>It is proposed to provide further that the provisions of Sections 224 to 226 shall apply mutatis mutandis to the appointment, remuneration and removal of Company Secretary in whole-time practice. Also same Company Secretary in practice shall not be reappointed for more than five consecutive accounting years and he shall, however, be eligible for appointment as such after expiry of five years from the end of his last term</p>	<p>It is desirable to bring Company Secretary in practice and statutory auditor at par with a view to ensure independence to Secretary in whole-time practice for issuing Compliance Certificate for companies. Further, in line with the perception on reappointment of same auditor, the same Company Secretary in practice shall not be reappointed for more than five consecutive accounting years so as to discourage nexus between the company secretary in practice and the management of the company. He shall, however, be eligible for appointment as such after expiry of five years from the end of his last term.</p>
37	410	<p><b>Appointment of Advisory Committee.</b></p> <p>For the purpose of advising the Central Government and the Company Law Board on such matters arising out of the administration of this Act as may be referred to it by that Government or Board, the Central Government may constitute an Advisory Committee" consisting of not more than five persons with suitable qualifications.</p>	<p>The provision for appointment of Advisory Committee is proposed to be omitted.</p>	<p>There are adequate opportunities now available facilitating interaction amongst Govt., Trade /Associates, and professional bodies and general public at large through debates workshops, seminars etc. The exchange of views, therefore, already takes place on regular basis on major policy issues. Hence, the need for a formal forum in the form of Advisory Committee has become irrelevant and therefore proposed to be omitted.</p>
38.	560	<p><b>Power of Registrar to strike defunct company off register.</b>  <b>(1)</b> Where the Registrar has reasonable cause to believe that a company is not carrying on business or in operation, he shall</p>	<p>It is proposed that where a company has not filed its balance sheet and profit and loss account for the last three consecutive years, the Registrar shall have powers to issue notice to the Company to show</p>	<p>There are large number of companies which are not in operation and not doing any business. The promoters of such companies are not interested to follow the long tedious route of</p>

(1)	(2)	(3)	(4)	(5)
		<p>send to the company by post a letter inquiring whether the company is carrying on business or in operation.</p>	<p>cause to the Registrar as to why its name should not be struck off and if no satisfactory answer is received, a notice will be published in one English newspaper and one vernacular newspaper circulating in the district of its registered office with a view to strike off the name of the company from the register.</p>	<p>liquidation to wind up such defunct companies. The requirements provided under striking off provisions has to be made simpler in order to wind up such companies and remove their names from the Register of Companies.</p>