International Journal of Management and Commerce Innovations ISSN 2348-7585 (Online)
Vol. 2, Issue 2, pp: (399-402), Month: October 2014 - March 2015, Available at: www.researchpublish.com

The Companies Act, 2013: A Significant Milestone

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Abstract: **Finally, the youngest Minister of Corporate Affairs has been successful in bringing the much awaited fresh perspective in the Corporate Law to its logical conclusion. It would only be fair to acknowledge several positive indications in the Companies Act, 2013 (referred to as the new Act), including self-regulation and appropriate empowerment. Overall it is a genuine attempt and a much awaited overhaul with the changing environment and forward thinking. Implementation and transition to comply with the new law would need regulatory support and change in the mindset. Corporates would need significant preparation and groundwork to abide by the law in substance. It is also necessary that the regulatory authorities ensure adequate monitoring and enforcement mechanism, in the absence of which the objective may not be achieved.**

The new Act contains only 470 clauses compared to 658 sections in the erstwhile Act. However, there appears to be more than 300 clauses that are subject to substantive rules to be prescribed. A combination of the proposed Act and the related Rules may turn out to be larger than the existing law. Timely response of the regulatory authorities to the challenges posed by multiple interpretations and related administration, would make implementation easier and is of utmost importance.

1. INTRODUCTION

The companies act, 1956, which was enacted with the object to consolidate and amend the law relating to companies and certain other associations, had been in force for about fifty-five years and had undergone several amendments. However, a need was felt to enact a new legislation to meet the changed national and international economic environment and to further accelerate the expansion and growth of economy. For this purpose the company bill, 2009 was introduced in the parliament. Subsequent to its introduction, the central government received several suggestions for amendments in the said bill. The parliament standing committee on finance also made numerous recommendations. In view of the many proposed amendments to the companies bill, 2009 arising out of the recommendations of the parliament standing committee on finance and suggestions of various stakeholders, the central government withdrew the companies bill, 2009 and introduce a fresh bill incorporating therein the recommendations of standing committee and suggestions of the stakeholders. On December 14, 2011 the companies bill 2011 was tabled in parliament. The Companies Bill, 2011 was also considered by the Parliamentary Standing Committee on Finance which submitted its report on 26 June 2012. Subsequently, the Bill was considered and approved by the Lok Sabha on 18 December 2012 as the Companies Bill, 2012 (the Bill). The Bill was then considered and approved by the Rajya Sabha too on 8 August 2013. It received the President's assent on 29 August 2013 and has now become the Companies Act, 2013.

The 2013 Act introduces significant changes in the provisions related to governance, e-management, compliance and enforcement, disclosure norms, auditors and mergers and acquisitions. Also, new concepts such as one-person company, small companies, dormant company, class action suits, registered valuers and corporate social responsibility have been included.

2. LITERATURE REVIEW

Though the new Act seems to be enthusiastic in spelling out accountability and reporting by the directors, it also encourages and provides necessary freedom and enough room for self-regulation. These are adequately reflected at several places in the form of removing bureaucratic approval process by the Central Government for various corporate actions, e.g., related party transactions, increase in number of directors, managerial remuneration, loans to directors, etc. However, there are clear expectations of better corporate governance, e.g., substantive disclosures to stakeholders, significant role of independent directors, transparency in related party transactions, etc. Importance to transparency is clearly reflected by way of disclosure requirements in the Directors' Responsibility Statement, which would need to include assurance on adequacy and effectiveness of internal financial controls; compliance with applicable laws and regulations; risk management policies and CSR initiatives; and manner of evaluation of annual performance of Boards/committees. A combination of these disclosures would help investors in understanding the status of governance, compliance and operational effectiveness. Besides prescribing the composition of the board of directors and audit committees, the new Act mandates inclusion of a woman director (for companies to be prescribed) and a director on the Board who has been in India for at least 182 days in the previous calendar year. These provisions indicate empowerment and operational effectiveness of management. In order to ensure that the directors devote adequate attention, the limit on number of directorships in public companies has been reduced to 10. However, the overall number has been increased to 20 as compared to 15 at present.

Freedom by way of self-governance is followed by stricter penal provisions for non-compliances. The stakeholders have also been empowered to initiate actions, e.g., introduction of class action suit is an extremely powerful tool towards protection of interest of investors. Similarly, there are severe penalties for insider trading. Such empowerment and significant penal provisions will bring in investor confidence and also a fear amongst those charged with governance to stay away from unethical practices to a large extent. For an effective implementation, it is important that there are adequate enforcement procedures and action against non compliances.

The new Act thrusts significant moral responsibility on independent directors to objectively discharge their functions. While regulation may only provide indicative guidance, corporate governance is a state of mind and the responsibility lies with those who deal with public resources. The expectation is to look beyond vested interests in order to safeguard the stakeholders. The new Act mandates rotation of independent directors by way of restricting their tenure to a maximum of 5 consecutive years, with an additional tenure of 5 years by way of special resolution. The period would be counted prospectively. To make it more restrictive, the new Act prohibits any stock options to independent directors.

The new Act poses significant emphasis on the independence of auditors. Principles like rotation of auditors in case of listed companies (other companies may be prescribed) are in that direction. It may still be debatable whether rotation of auditors would objectively address the concerns regarding their independence and whether it would result in an approach balanced with efficiency and quality. The new Act provides a mechanism of appointment of auditors for a block of 5 years instead of reappointment at every AGM. Rotation of auditors and extended reporting responsibilities are likely to increase the cost of audit of financial statements under the new regime. Concept of rotation of auditors has not been extended to government companies. Auditors would have extended reporting responsibilities regarding internal financial controls and frauds in a company.

The onus to prove that the related party transactions are at an arm's length and are in the ordinary course of business, gets shifted to the management. The new Act removes the government approval regime. The coverage of related party transactions has also been enlarged for better governance.

While the new Act provides significant powers to the stakeholders in several areas, it has been cautious and has tried to avoid undue harassment to corporates in procedures like compromise/arrangements/ amalgamations. Stakeholders would need to fulfil minimum eligibility criteria/threshold to raise any objections to such schemes. This would avoid frivolous litigations and unnecessary delays.

The new Act also makes sense in terms of synchronising the size of a business and corresponding applicability of law, without over-regulation. This would encourage unorganised business structures to become part of a corporate regime, with better resources and enhanced growth opportunities. The New Act contains several concepts and forms of entities, e.g., one-person company; different forms of private companies; listed and unlisted public companies; dormant companies, etc. Besides this, the new Act also recognises larger association of persons.

The concept of corporate social responsibility (CSR) may sound a bit imposing. However, it appears to be an appeal to seek support to enhance a social infrastructure. By way of making CSR a part of the regulation, the Government looks up to the capable corporate world, based on the prescribed criteria, to genuinely fulfil its responsibility and create social projects to help society. Since the New Act states that the company which meets the prescribed criteria spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years. It appears that the CSR spend would be a mandatory requirement. However, the New Act also states that if the company fails to spend such amount, the Board shall, in its report specify the reasons for not spending the amount. Therefore, it seems that although the intent of the Board has to make all efforts to spend the specified amount towards CSR, if, for any reason, the same could not be successfully achieved, it would be the responsibility of the Board to make adequate disclosures. *This is a wonderful example of self-governance*. It would be embarrassing for any corporate to disclose a complete failure of its CSR plan despite the regulatory requirement of a well-defined and established CSR Committee; appointment of an independent director on the committee; formulation of a CSR policy and the proposed activities; duly recommended amount of CSR expenditure to be incurred; monitoring the policy from time to time; and the Board's responsibility to ensure that the activities included in the CSR policy are undertaken. It also appears that purely monetary contributions to comply with the CSR norms may not be encouraged. Possible deductibility for taxation purposes may be a motivating factor to an extent.

The new Act provides opportunities to corporates for cross-border expansions and mergers including reverse mergers. Certainly the RBI would play an important role in framing rules for implementation. Also there are several simplified procedures, e.g., merger of wholly-owned subsidiary company without court approvals, which would provide significant relief from prolonged and avoidable regulatory process.

The new Act has included a concept of Registered Valuer. Valuations required in terms of the provisions of the new Act would be carried out by a Registered Valuer. Eligibility criteria to be a Registered Valuer would be prescribed.

Accounting under the new regime would reflect a strong international flavour with introduction of mandatory consolidation of financial statements. It appears that the domestic and international investor community was longing for requisite information of real ownership structure/financial position and a clear identity of a corporate. The significant counts of subsidiaries and other associated companies, along with web of circular transactions, largely in closely held private companies, were the easiest tools of camouflaging. Fortunately, SEBI could bring in some sanity in case of listed companies. However, out of a total of around 12.9 lakh companies in India, there are around 11.7 lakh private companies, with few thousands listed companies. The new Act intends to ensure a very clear disclosure of real ownership and impact of transactions within commonly controlled ownership structures. Amendment in the definition of subsidiary company is a logical and substantive move, which is likely to significantly increase the number of companies liable to prepare consolidated financial statements. This would be a credible move towards converging with international accounting standards, which primarily recognise consolidated financial statements instead of standalone accounts. In order to avoid conflicts and divergent practices, it seems that regulatory will bridge the gap between definitions as per the new Act (e.g., subsidiary; associate; joint venture, etc.) and in the accounting standards.

The new Act also contains provisions for reopening/ recasting the financial statements of earlier years at the instance of the Central Government or various other regulatory authorities in case the relevant earlier accounts were prepared in a fraudulent manner or the affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of the financial statements. Presently, under the Indian GAAP, any corrections relating to the prior years are undertaken in the current period financial statements, without reopening or recasting the prior years.

The concept of uniform financial year, barring few exceptions, would help in better comparability and understanding. The new Act poses restrictions on multiple layers of subsidiaries, except in certain specific circumstances. This is another step to ensure transparency in case of chain structures without substance. The underlying rules would hopefully provide adequate directions for implementation and also the transitional provisions for existing structures.

The new Act continues to prescribe estimated maximum lives of depreciable assets. As a part of self-governance, such decisions could have been left to the management to avoid possible thumb rules. For instance, in case of a continuous process plant, the estimated maximum life of 8 years (as compared to 18 years as per the previous law) may need to be revisited. Reduction in lives of fixed assets may lead to a significant burden on the statement of profit and loss of several corporates.

Concerns have been rightly expressed on the creation of structures like the National Financial Reporting Authority (NFRA). NFRA sounds to be a strict monitoring mechanism which will have investigative powers into the professional or other misconduct committed by external auditors and even debarring them from practice for a period of up to 10 years in case such misconduct is proved.

3. OBJECTIVE OF THE STUDY

a) To promote the development of the economy by encouraging entrepreneurship and enterprise efficiency and creating flexibility and simplicity in the formation and maintenance of companies.

b) To encourage transparency , accountability and high standards of corporate governance

c) To recognize various new concepts and procedures facilitating ease of doing business while protecting interests of all the stakeholders

d) To enforce stricter action against fraud and gross non-compliance with company law provisions

e) To set up institutional structure in the form of various authorities, bodies and panels as well as by including recognition of various roles for professionals and other experts

f) To cater to the need for more effective and time bound approvals and compliance requirements relevant in the present context.

4. CONCLUSION

In view of changes in the national and international economic environment and expansion and growth of economy of our country, the central government after due deliberations decided to repeal the companies act, 1956 and enact a new legislation to provide for new provisions to meet the changed national and international, economic environment and further accelerate the expansion and growth of our economy.

The introduction of a new Companies Act, after the old Act has served all for over five decades, is a welcome and a significant step. The intentions of the Central Government, particularly the MCA, in drafting this law with several new provisions and concepts and prescribing extensive Rules to make the law dynamic and responsive to the needs of the corporate sector are greatly laudable. While the corporate sector would certainly be expected to conduct its affairs responsibly and transparently, the government would have to demonstrate that its intentions are to encourage the corporate sector and not to stifle or strangulate it. If the corporate sector prospers, society and all its stakeholders will prosper. The Government and the corporate sector must work together to build mutual confidence and help advance the economic development of India. Each one of us may have a different perspective with regard to the new company law but let us believe for a moment that the new law has been introduced by the central government with the best intentions and that it is now the turn of the corporate sector to demonstrate that it will play according to the Rules. The government on its part must trust the corporate sector to function honestly but keep a watch.

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