

Companies Bill, 2012 – Facts and Emerging Impact



The new law has many facets bringing positive impact for integrating India Inc at par with World Inc. With the presence and emergence of vast international corporate entities vying to set up their units in India, it has addressed issues of transparency, shareholders' activism, corporate democracy, enhancing minority rights, ensuring accountability of the Board and to inculcate a sense that corporate houses are not only profit and wealth creation units but also socially responsible. The attempts of the Government in reshaping, tweaking and slimming the age old company law is a Bold and Golden step to place India on a global platform. This article overviews some of the sensitive changes made in relation to accounts and audit by way of its facts and emerging impact. Read on...



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The Company Law of a country is the epitome of economic growth, signifying and signaling how far the rules of a business game should be in sync with international best practices. Restructuring, reshaping and regulating such a business law of a country is a journey towards excellence with no destination. Compacting 32 Chapters into 27, Reducing 658 sections to 470 and Slimming from XVI Schedules into VII as a finer fit (if not a slim fit) of an aged law is an uphill task for the Government. The Companies Act, 1956, though amended 26 times, the time taken to get across the various stakeholders' table, tabling before the House of the Parliament and to get its passage has always been a pedaling hurdle. An illustrative amendment attempt that was taken way back in 2002

for constitution of National Company Law Tribunal (NCLT) resulted in only amendment in law and yet NCLT could not be formed. After the amendment in 2002, it was followed by the Companies Bill as 2008, 2009, 2011 and 2012. After 10 years, the Companies Bill, 2012 could see some light as it got the passage of the Lok Sabha on the night of 18th December, 2012 and is now awaiting the clearance by Rajya Sabha. The new law will be administered mostly by Rules. The words '*as may be prescribed*' has been used at 303 places in various provisions, where Rules have to be framed for around 180 sections and are yet to be open for public discussion. The new law has many facets bringing a positive impact for integrating India Inc at par with World Inc. With the presence and emergence of vast international corporate entities vying to set up their units in India, it has addressed issues of transparency, shareholders' activism, corporate democracy, enhancing minority rights, ensuring accountability of the Board and to inculcate a sense that corporate houses are not only profit and wealth creation units but also socially responsible. As many as 36 new definitions (see box) have been incorporated in the Bill and other 36 existing definitions have been modified. The attempts of the Government in reshaping, tweaking and slimming the age old company law is a Bold and Golden step to place India on a global platform.

New Definitions incorporated in Section 2 of the Bill, 2012

Associate company, Auditing standards, Authorised capital or nominal capital, Books of account, Called up capital, Charge, Chartered Accountant, Chief Executive Officer, Chief Financial Officer, Company Liquidator, Control, Cost Accountant, Expert, financial statement, Global depository receipt, Independent Director, Indian depository receipt, Issued capital, Key managerial personnel, Notification, One Person Company, Ordinary or Special Resolution, Paid-up Share Capital or share capital paid-up, Postal ballot, Promoter, Register of companies, Related party, Serious Fraud Investigation Office, Small company, Subscribed capital, Tribunal, Turnover, Unlimited company, Voting right, Whole-time director

Constitution of National Financial Reporting Authority – NFRA (Section 132)

The Bill, 2012 provides for the very first time constitution of a new authority, namely the National Financial Reporting Authority. The earlier Bills

(of 2008, 2009) did not contain/mention/provision about NFRA. Even the Parliamentary Standing Committee on Finance which examined the Companies Bill is silent on the aspect. The terms of reference for NFRA are significantly different, setting a new tone and tenor for regulating accounting profession in India.

Terms of Reference for NFRA

- *Make recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies or class of companies or their auditors, as the case may be;*
- *Monitor and enforce the compliance with accounting standards and auditing standards in such manner as may be prescribed;*
- *Oversee the quality of service of the professions associated with ensuring compliance with such standards, and suggest measures required for improvement in quality of service and such other related matters as may be prescribed; and*
- *Perform such other functions relating to the above as may be prescribed.*

The National Financial Reporting Authority shall consist of a Chairman and such other 15 members consisting of part-time and full-time members. It is not mentioned as to the percentage of full-time and part-time members and their duties and responsibilities. The Chairperson and full time members are restricted to associate with any audit firm (including related consultancy firms) during the course of their term and two years after ceasing to hold such appointment. This is similar to restriction laid by the Competition Act 2002 on its Chairperson and other members for

Considering NFRA is a new set-up and is extending its arm's length towards accounting and auditing, one hopes that spirit of NFRA should enhance the Financial Regulatory system in India and 'Not For Regulating Accountant'. Clause 132 (4) is a non-obstante clause providing a bar on any other body or institute in initiating or continuing the proceedings in case of matters relating to misconduct as referred in the Chartered Accountants Act, 1949. It is to be seen as to how far these 'embargoes' on the powers of other institute/body already enacted under an Act of Parliament hold and behold the spirit of the accounting profession in India.

a period of two years from the date on which they cease to hold office, to accept any employment in any enterprise which has been a party to a proceeding before the Commission under the Act.

Powers of NFRA

- Power to investigate, either *suo moto* or on a reference made to it by the Central Government, for such class of bodies corporate or persons, in such manner as may be prescribed into the matters of professional or other misconduct (as referred in Section 22 of the Chartered Accountants Act, 1949) committed by any member or firm of chartered accountants, registered under the Chartered Accountants Act, 1949.
- Once NFRA initiates or continue any proceedings under the Act, no other institute or body shall initiate or continue any proceedings.
- NFRA shall have same powers as are vested in a Civil Court.
- Apart from imposing penalty it can debar the member or the firm from engaging himself or itself from practice as member of the Institute of Chartered Accountants of India for a minimum period of six months or for such higher period not exceeding ten years as may be decided by the National Financial Reporting Authority. Any person aggrieved by the order of NFRA can appeal before the Appellate Authority.

The constitution of NFRA poses certain concerns and issues:

- Is NFRA a replacement of National Advisory Committee on Accounting Standards (NACAS)?
- Is NFRA an autonomous and independent regulator?
- Clause 132 (4) is a *non-obstante* clause providing a bar on any other body or institute in initiating or continuing the proceedings in case of matters relating to misconduct as referred in the Chartered Accountants Act, 1949. It is to be seen as to how far this 'embargo' on the powers of other institute/body already enacted under an Act of Parliament hold and behold the spirit of the accounting profession in India.
- The structure and hierarchy of NFRA and the time limits within which it shall dispose of the investigation proceedings is not known.
- Considering NFRA is a new set-up and is extending its arm's length towards accounting and auditing, one hopes that the spirit of NFRA should enhance

the Financial Regulatory system in India and 'Not For Regulating Accountant'.

Rotation of Auditors (Section 139)

The Bill provides for the system of rotation of auditors and audit firms. This is the first time in the history of company law in India that auditors shall be subject to rotation after certain specified number of years. Though rotation of auditors has not been an encouraging success internationally, in its wisdom and to restrict the lineage and linkage of relationship of the auditor and the auditee, the Bill provides that no listed companies or class of companies shall appoint or reappoint an individual as an auditor for more than one term of five consecutive years and audit firm as an auditor for more than two terms of five consecutive years. This is further subject to the provision that in case of audit firm, members may resolve to provide for such intervals of rotation for audit team and its partners and providing for audit by more than one auditor (joint auditor). The system of rotation of auditor and audit firm is to take effect retrospectively (as on the date on which the Act may come into force) and the period of office of auditor completed earlier will be taken into account in calculating the term of five and two terms of five years respectively for individual auditor and for the audit firm. A transition period of 3 years from the commencement of the Act has been prescribed for the companies existing on or before the commencement of the Act, to comply with the provisions relating to rotation of auditors/audit firm.

The issues relating to rotation are laudable and debatable for its efficacy and efficiency. On the one hand, it delinks the longer relationships of auditor vis-à-vis the auditee. On the other hand, it takes time for the new auditor to understand the business unit and its industry practices. An auditor should not only remain independent but be seen as independent. Does rotation bring independence? In a country where there are thousands of Small and Medium Practitioners, it is difficult to realign their proprietary into a firm for getting the scope of being auditor for two terms of five years.

Cap on Audit Assignments

The Bill disallows an auditor or an audit partner from auditing more than 20 companies. Earlier the limit was 30 excluding that of private companies. It is to be further seen from the Rules that whether private companies, small company, one-person company are excluded in calculating the prescribed limit of 20.

Removal of auditors (Section 140)

If the Tribunal on *suo moto* or an application from Central Government or any person concerned is satisfied that the auditor of a company has acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to the company or its directors or officers whether directly or indirectly, it can direct the company to change the auditor. Such auditor shall not be eligible for appointment as auditor for a period of 5 years against whom the order has been passed by the Tribunal and he shall also be liable for action under section 447 which deals with punishment for fraud. The liabilities will also extend in case of firm and that of every partner or partners.

Qualifications and Disqualifications of Auditors (Section 141)

In addition to the disqualifications provided in the existing Act, the Bill further provides that the auditor himself or his relative or partner shall not hold any security or is indebted or has provided any guarantee in the company or its holding or subsidiary or associate company except that the relative may hold security or interest in the company of face value not exceeding ₹1,000 or such sum as may be prescribed. Further it provides that a firm where majority of the partners practicing in India are qualified for appointment may be appointed by its firm name as auditor of the company. More than his qualifications as an auditor, he should be aware and beware that he knows who are all his relatives and the fact of their holdings in the companies in which he is appointed as an auditor.

Remuneration of Auditor (Section 142)

The remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined. Such remuneration shall also include the expenses incurred by the auditor in connection with the audit of the company and also any facility extended to him.

Powers and Duties of Auditors (Section 143)

Apart from the powers that are already provided in the Act, 1956, the auditor in his report is to include any qualification, reservation, or adverse remark relating to the maintenance of accounts and other matters connected therewith and also to state whether the company has adequate internal financial control systems in place and its operating efficiency. Further, the auditor is required to provide reasons in the auditor's report for any negative remarks or with a

qualification. Also any qualifications, observations or comments on financial transactions or matters which have adverse effect on the functioning of company mentioned in the auditor's report shall be read before the company at its general meeting. Further, auditor or his representative who shall also be qualified to be the auditor shall mandatorily attend all the general meetings of the company. The auditor is now required to comply with the auditing standards.

Penalty for Auditors for Contravention (Section 147)

The clause provides that in cases of contravention of appointment, powers, duties, services, signing of auditors report, the auditor shall be punishable with fine which shall not be less ₹25,000 and may extend to ₹5 lakh. In case of willful contravention and with intention to deceive the company/shareholders/creditors/tax authorities, he shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than ₹1 lakh and which may extend to ₹25 lakh or both. In case he contravenes the provisions relating to his powers and duties, rendering of services and attendance of meetings, the penalty shall be that he shall be required to refund the remuneration received from the company and to pay the damages to the company, statutory bodies, or authorities or to any person arising out of loss out of misleading or incorrect information.

The list of onerous duties and responsibilities of an auditor does not end. He is also expected to be a whistle-blower. Section 143(12) casts the duty on the auditor to report to CG any offence involving fraud committed against the company by officers or employees of the company. Further he is also subjected to class action suits.

The new Bill is going to change the way companies are incorporated, raise money, interact with stakeholders, govern themselves and contribute to nation-building. On the one hand, the Bill has brought out several new concepts and opens up various professional opportunities and on the other hand burdens the corporates and professionals with lots of duties and responsibilities. Nevertheless, the Bill, 2012 is expected to usher vistas and vision for the Indian corporate environment in line with the best international practices. The journey from 1956 to 2012 brought in several experiences and the law which was a goliath finally went into a gym for its trimming and slimming its size to turn India into a better place for global business. ■