EXECUTIVE PROGRAMME

Supplement For

- COMPANY LAW (Module 1, paper 1)
- COST AND MANAGEMENT ACCOUNTING (Module 1, paper 2)
- TAX LAWS AND PRACTICE (Module 1, paper 4)
- COMPANY ACCOUNTS AND AUDITING PRACTICES (Module 2, paper 5)
- CAPITAL MARKETS AND SECURITIES LAWS (Module 2, paper 6)

This supplement is based on those sections of the Companies Act, 2013 and the rules made there under which have been notified by the Government of India and came into force w.e.f. April 01, 2014 (Including amendments / clarifications / circulars issued there under upto June, 2014). In respect of sections of the Companies Act, 2013 which have not been notified, applicable sections of Companies Act, 1956 have been dealt with.

The students having 2013 edition of Study Material (New Syllabus) are advised to read their Study Material with reference to this supplement. This supplement is updated upto 30th June, 2014.
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Lesson 11
COST ACCOUNTING RECORDS AND COST AUDIT

LESSON OUTLINE

• Cost audit
• Provisions of Companies Act, 2013, pertaining to cost accounting records
• Provisions of Companies Act, 2013 pertaining to cost audit
• Purpose of cost audit
• Scope of cost audit
• Advantages of cost audit
• Appointment and Remuneration of cost auditor
• Rights and responsibilities of cost auditor
• Punishment for contravention
• Cost audit techniques
• Cost audit programme.
• Cost audit report
• Lesson Round Up
• Self-Test Questions

LEARNING OBJECTIVES

Section 2(13)(iv) of the Companies Act, 2013 contains the provisions relating to maintenance of cost accounting records and Section 148 of the Act contains the provisions relating to Cost Audit. Introducing statutory requirement of maintenance of cost accounting records and audit thereof as applicable by a qualified cost accountant, the Government has the objectives and reasons for ensuring that the companies keep proper records was to inculcate a culture of cost consciousness among industries for better resource management, to make the efficiency audit possible, and to make cost data available to the Government.

The objectives of this lesson are to enable the student to understand the meaning of cost accounting records, the purposes for which cost records are being maintained, meaning of cost audit, various techniques used in cost audit etc. The study of this lesson will help one to understand the nature, scope and utility of cost accounting records and cost audit.
COST AUDIT

Cost audit is an independent examination of cost records and other related information of an entity including a non-profit entity, when such an examination is conducted with a view to expressing an opinion thereon.

(As per definition of CAAS 101)

COST AUDIT

Cost audit is an independent examination of cost records and other related information of an entity including a non-profit entity, when such an examination is conducted with a view to expressing an opinion thereon.

Cost audit comprises of the followings:

(a) Verification of the cost accounting records for the accuracy of the cost accounts, cost reports, cost statements and cost data and

(b) Examination of these records to ensure that they adhere to the cost accounting principles, plans, procedures and objectives.

It, therefore, means that the cost auditors’ approach should be to ensure that the cost accounting plan is in consonance with the objectives set by the organisation and the system of accounting is geared towards the attainment of these objectives. The cost auditor should also establish the correctness or otherwise of the figures by the processes of vouching verification, reconciliation etc.

PROVISIONS OF COMPANIES ACT, 2013 PERTAINING TO COST ACCOUNTING RECORDS

Section 2(13) and section 128 of the Companies Act, 2013 deals with the books of accounts to be kept by a company. According to section 2(13) on the Companies Act, 2013 “books of account” includes records maintained in respect of-

(i) all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;

(ii) all sales and purchases of goods and services by the company;

(iii) the assets and liabilities of the company; and

(iv) the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section;

Section 128 on the Companies Act, 2013 provides that every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches and such books shall be kept on accrual basis and according to the double entry system of accounting.

Further all or any of the books of account aforesaid and other relevant papers may be kept at such other place in India as the Board of Directors may decide and where such a decision is taken, the
company shall, within seven days thereof, file with the Registrar a notice in writing giving the full address of that other place.
Provided further that the company may keep such books of account or other relevant papers in electronic mode in such manner as may be prescribed.

In exercise of powers conferred by section 469(1) and (2) read with section 2(13)(iv), section 128 and section 148 of the Companies Act, 2013, the Central Government prescribes the Companies (Cost Records and Cost Audit) Rules, 2014 for the maintenance of cost records relating to the utilization of materials, labour and other items of cost, in the manner as prescribed by specified class of companies, including foreign companies defined in section 2(42) of the Companies Act, 2013, engaged in the production of such goods or providing such services as may be prescribed.

PROVISIONS OF COMPANIES ACT, 2013 PERTAINING TO COST AUDIT

Section 148 of the Companies Act, 2013 deals with the audit of Cost Accounting records. The section provides as follows:

(1) Notwithstanding anything contained in Chapter X of Companies Act 2013, the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies. However, the Central Government shall, before issuing such order in respect of any class of companies regulated under a special Act, consult the regulatory body constituted or established under such special Act.

(2) If the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered under sub-section (1) and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order.

(3) The audit under sub-section (2) shall be conducted by a Cost Accountant in practice who shall be appointed by the Board on such remuneration as may be determined by the members in such manner as may be prescribed. Further no person appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records and the auditor conducting the cost audit shall comply with the cost auditing standards. 

Explanation.—for the purposes of this sub-section, the expression “cost auditing standards” mean such standards as are issued by the Institute of Cost and Works Accountants of India, constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government.

(4) An audit conducted under this section shall be in addition to the audit conducted under section 143.

(5) The qualifications, disqualifications, rights, duties and obligations applicable to auditors under this Chapter (Chapter X: Audit and Auditors) shall, so far as may be applicable, apply to a cost
auditor appointed under this section and it shall be the duty of the company to give all assistance and facilities to the cost auditor appointed under this section for auditing the cost records of the company:
Provided that the report on the audit of cost records shall be submitted by the cost accountant in practice to the Board of Directors of the company.

(6) A company shall within thirty days from the date of receipt of a copy of the cost audit report prepared in pursuance of a direction under sub-section (2) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein.

(7) If, after considering the cost audit report referred to under this section and the information and explanation furnished by the company under sub-section (6), the Central Government is of the opinion that any further information or explanation is necessary, it may call for such further information and explanation and the company shall furnish the same within such time as may be specified by that Government.

(8) If any default is made in complying with the provisions of this section,—
   (a) the company and every officer of the company who is in default shall be punishable in the manner as provided in sub-section (1) of section 147;
   (b) the cost auditor of the company who is in default shall be punishable in the manner as provided in sub-sections (2) to (4) of section 147.

PURPOSE OF COST AUDIT

The primary purpose of Cost audit is to express an opinion on the cost accounts of the company whether these have been properly maintained and compiled according to the cost accounting system followed by the enterprise or not. However the purposes of cost audit may be segregated into general and social objectives. The general objectives can be described to include the following:

   (1) Verification of cost accounts with a view to ascertaining that these have been properly maintained and compiled according to the cost accounting system followed by the enterprise.
   (2) Ensuring that the prescribed procedures of cost accounting records rules are duly adhered to.
   (3) Detection of errors and fraud.
   (4) Verification of the cost of each “cost unit” and “cost centre” to ensure that these have been properly ascertained.
   (5) Determination of inventory valuation.
   (6) Facilitating the fixation of prices of goods and services.
   (7) Periodical reconciliation between cost accounts and financial accounts.
   (8) Ensuring optimum utilization of human, physical and financial resources of the enterprise.
   (9) Detection and correction of abnormal loss.
   (10) Inculcation of cost consciousness.
(11) Advising management, on the basis of inter-firm comparison of cost records, as regards the areas where performance calls for improvement.

(12) Promoting corporate governance through various operational disclosures.

**Social purposes of cost audit**

The following deserve special mention

1. Facilitate in fixation of reasonable prices of goods and services produced by the enterprise.
2. Improvement in productivity of human, physical and financial resources of the enterprise.
3. Channelise enterprise resources to most optimum, productive and profitable areas.
4. Availability of audited cost data as regards contracts containing escalation clauses.
5. Facilitate in settlement of bills in the case of cost-plus contracts entered into by the Government.
6. Pinpointing areas of inefficiency and mismanagement, if any for the benefit of shareholders, consumers, etc., such that necessary corrective action could be taken in time.

**APPLICABILITY FOR COST AUDIT**

Every such class of company and with such threshold limit as may be prescribed in the Companies (Cost Record and Cost Audit) Rules, 2014, shall be required to get such cost records audited by a cost auditor.

**Cost Audit**

Every company covered under Rule 3 of the Companies (Cost Records and Cost Audit) Rules, 2014 and with such threshold limits as specified in the Rules shall within one hundred and eighty days of the commencement of every financial year appoint a cost auditor. The company shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of thirty days of the Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in **form CRA-2**, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

Further every cost auditor appointed as such shall continue in such capacity till the expiry of one hundred and eighty days from the closure of the financial year or till he submits the cost audit report, for the financial year for which he has been appointed. The cost auditor, who conducts an audit of the cost records of a company, shall submit the cost audit report along with his or its reservations or qualifications or observations or suggestions, if any, in **form CRA-3**.

The cost auditor shall forward his report to the Board of Directors of the company within a period of one hundred and eighty days from the closure of the financial year to which the report relates and the Board of directors shall consider and examine such report particularly any reservation or qualification contained therein.

Every company covered above shall, within a period of thirty days from the date of receipt of a copy of the cost audit report, furnish the Central Government with such report along with full

The Companies (Cost Records and Cost Audit) Rules, 2014 not to apply in certain cases.- The requirement for cost audit under these rules is not applicable for the following categories of companies even though they are covered under applicable class of companies mentioned in the Rule 3:

(i) whose revenue from exports, in foreign exchange, exceeds seventy five per cent of its total revenue or
(ii) which is operating from a special economic zone.

ADVANTAGES OF COST AUDIT

Cost audit provides numerous benefits to the management, society, shareholders and the government. The advantages are as under:

Advantages to Management

(i) Management gets reliable data for its day-to-day operations like price fixing, control, decision-making, etc.
(ii) A close and continuous check on all wastages will be kept through a proper system of reporting to management.
(iii) Inefficiencies in the working of the company will be brought to light to facilitate corrective action.
(iv) Management by exception becomes possible through allocation of responsibilities to individual managers.
(v) The system of budgetary control and standard costing will be greatly facilitated.
(vi) A reliable check on the valuation of closing stock and work-in-progress can be established.
(vii) It helps in the detection of errors and fraud.

Advantages to Society

(i) Cost audit is often introduced for the purpose of fixation of prices. The prices so fixed are based on the Audit Cost data and so the consumers are saved from exploitation.
(ii) Since price increase by some industries is not allowed without proper justification like increase in cost of production, inflation through price hikes can be controlled and consumers can maintain their standard of living.

Advantages to Shareholder

Cost audit ensures that proper records are kept as to purchases and utilisation of materials
and expenses incurred on wages, etc. It also makes sure that the valuation of closing stocks and work-in-progress is on a fair basis. Thus the shareholders are assured of a fair return on their investment.

Advantages to Government

(i) Where the Government enters into a cost-plus contract, cost audit helps government to fix the price of the contract at a reasonable level.

(ii) Cost audit helps in the fixation of ceiling prices of essential commodities and thus undue profiteering is checked.

(iii) Cost audit enables the government to focus its attention on inefficient units.

(iv) Cost audit enables the government to decide in favour of giving protection to certain industries.

(v) Cost audit facilitates settlement of trade disputes brought to the government.

(vi) Cost audit and consequent management action can create a healthy competition among the various units in an industry. This imposes an automatic check on inflation.

APPOINTMENT AND REMUNERATION OF COST AUDITOR

“Cost Accountant in practice” means a cost accountant as defined in clause (b) of subsection (1) of section 2 of the Cost and Works Accountants Act, 1959 (23 of 1959), who holds a valid certificate of practice under sub-section (1) of section 6 of that Act and who is deemed to be in practice under sub-section (2) of section 2 thereof, and includes a firm or limited liability partnership of cost accountants.

Every company covered under the Companies (Cost Records and Cost Audit) Rules, 2014 and with such threshold limits as specified in the Rules shall within one hundred and eighty days of the commencement of every financial year appoint a cost auditor at remuneration to be determined in accordance with provisions of section 148(3) and rules made thereunder.

Provided that before such appointment is made, written consent of the cost auditor to such appointment, and a certificate that the appointment, if made, shall be in accordance with the provisions of section 139, section 141 and section 148 of the Companies Act, 2013 and the rules made thereunder, as applicable shall be obtained from the cost auditor.

For the purpose of sub-section (3) of section 148 of the Companies Act, 2013—

(a) in the case of companies which are required to constitute an audit committee*—

(i) the Board shall appoint an individual, who is a cost accountant in practice, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee, which shall also recommend remuneration for such cost auditor;

(ii) the remuneration recommended by the Audit Committee under (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;

(b) in the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant in practice or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.
[* An Audit committee shall be constituted by the Board of directors of every listed company and
the following classes of companies-
(i) all public companies with a paid up capital of ten crore rupees or more;
(ii) all public companies having turnover of one hundred crore rupees or more;
(iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or
deposits exceeding fifty crore rupees or more.
Explanation.- The paid up share capital or turnover or outstanding loans, or borrowings or
debentures or deposits, as the case may be, as existing on the date of last audited Financial
Statements shall be taken into account for the purposes of this rule.]

RIGHTS AND RESPONSIBILITIES OF COST AUDITOR

Section 148 of the Companies Act 2013 gives the cost auditor same powers as the financial auditor
has under section 143 of the Companies Act, 2013, which requires that the company and every
officer thereof, shall make available to the cost auditor, such information and explanation as he may
consider necessary for the performance of his duties as cost auditor and submit his report within the
prescribed time limit.

Rights of Cost Auditor

The powers of the cost auditor under sub-Section (1) of Section 143 are as under:

- Right to access at all times the books of account and vouchers of the company, whether
  kept at the head office of the company or elsewhere.
- Entitled to require from the officers of the company such information and explanations as
  he may think necessary for the performance of his duties as an auditor.

PUNISHMENT FOR CONTRAVENTION

(1) For Cost Auditor

If default is made by the cost auditor in complying with the provisions of section 139, section 143,
section 144 or section 145 of the Companies Act, 2013 then he shall be punishable in the manner as
provided in sub-section (2) to (4) of section 147 of the Companies Act, 2013. According to section
147 (2) of the Companies Act, 2013, the auditor shall be punishable with fine which shall not be
less than twenty-five thousand rupees but which may extend to five lakh rupees:
Provided that if an auditor has contravened such provisions knowingly or willfully with the
intention to deceive the company or its shareholders or creditors or tax authorities, he shall be
punishable with imprisonment for a term which may extend to one year and with fine which shall
not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

According to section 147(3) of the Companies Act, 2013, where an auditor has been convicted
under section 147 (2) above, he shall be liable to—
(i) refund the remuneration received by him to the company; and
(ii) pay for damages to the company, statutory bodies or authorities or to any other persons for loss
arising out of incorrect or misleading statements of particulars made in his audit report.

According to section 147(4) of the Companies Act, 2013, the Central Government shall, by
notification, specify any statutory body or authority or an officer for ensuring prompt payment of
damages to the company or the persons under clause (ii) section 147(3) and such body, authority or
officer shall after payment of damages to such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification.

The provision of section 143 of the Companies Act, 2013 applies *mutatis-mutandis* to Cost Accountants in practice conducting Cost Audit under section 148 of the Companies Act, 2013. If any cost accountant in practice fails to comply with the provisions of section 143(12) of the Companies Act, 2013, for reporting of an offence involving fraud, they will be punished with a fine of minimum Rs. 1 lakh and upto Rs. 25 lakhs.

(2) For Company
If a company contravenes any provisions of section 139 to 146 of the Companies Act, 2013, the company and every officer thereof who is in default shall be punishable in the manner as provided in section 147(1) of the Companies Act, 2013, wherein the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees, or with both.

**COST AUDIT TECHNIQUES**

There are no specific techniques being used by cost auditor in carrying out the cost audit assignments. Techniques employed by a Cost auditor in effectively carrying out his audit are –

(i) **Accounting or economic techniques**

1. Vouching.
2. Physical Verification.
3. Comparison of data with Peer.
4. Break-even analysis.
5. Budgetary control including flexible budget system.
6. Cost management techniques indicating how an organization’s assets should be allocated over competing projects or to decide whether it is worth proceeding with the investment, keeping in view proportionate value of expenditure on such projects.
7. Discounted cash flow and net present value methods.
8. Cost benefit analysis.
10. Activity based costing to test the relevance of cost to activities.
11. Quality analysis of company transactions.

(ii) **Scientific Techniques**

(a) *Computer Models*: There are many types of problems which can be solved on a computer e.g. decision on material mix, product mix, make or buy decisions etc.

(b) *Network analysis*: To analyse strings of tasks to arrange them in sequential or parallel order
so that the project is completed in a shortest possible time.

(c) Mathematical Programme solving by heuristic (trial and error) techniques to determine the best material mix, best use of organization’s transport fleet, the best mix of products to obtain or to maximize profits and optimum use of labour, finance, equipments, etc.

**(iii) Statistical Techniques**

(a) Activity Sampling: It is one of the many ways in which the present workloads can be measured to obtain controls to be exercised by management.

(b) Monte Carlo Simulation: In this a number of variables are drawn from large statistical population which have equal choice of being selected and obtain the best sample possible.

(c) Exponential smoothing

(d) Inter firm comparison

**(iv) Personnel Techniques**

(a) Attitude survey

(b) Ergonomic (Man-machine relationship)

(c) Training methods

(d) Profitability and productivity measurement

**(v) General techniques**

(a) Statistical theory of management is an attempt to emphasize what should be the practical approach to a problem by –

- Analyzing the problem to establish the basic difficulties and factors involved.
- Establish management by objectives.
- Identifying the likely ways of tackling the problems in the light of objectives to develop a solution.
- Determine the key factors affecting management decision-making.
- Evaluating alternative courses of action.
- Evaluating each alternative in terms of economy, efficiency and best fit.
- Specifying the action required to exploit the situation to the best advantage of the organization.

(b) Brain storming

(c) Transfer pricing

(d) Management by objectives

(e) Management by exception

(f) Corporate planning

(g) Information theory

**COST AUDIT PROGRAMME**

Cost audit programme is an essential prerequisite for conducting an audit. It is a plan of action
drawn in advance before taking up the audit, and to help the auditor to cover the entire area of his function thoroughly.

The audit programme should include all the usual broad steps that a financial auditor include in his audit programme. However, the significant things that should not be missed are: proper vouching of expenses, capital and revenue character determination, allocation of expenses, apportionment of overheads, arithmetical accuracy, the statutory requirements, examination of contracts and agreements, review of the Board’s and shareholders’ minute books to trace important decisions having bearing on costs, verification of title deeds and documents relating to properties and assets, etc. Cost audit, in order to be effective, should be completed at one time as far as practicable. The exact content of cost audit largely depends on the size of the organisation, range of products, production process, the existence of a well organised costing department and of a well designed costing system, and the existence of a capable internal auditing system. Other relevant considerations may be:

(A) Review of Cost Accounting Records

This will include:

1. Method of costing in use - batch, process or unit.
2. Method of accounting for raw materials; stores and spares, wastages, spoilage, defectives, etc.
3. System of recording wages, salaries, overtime and spares, wastages, etc.
4. Basis of allocation of overheads to cost centres and apportionment of service department’s expenses.
5. Treatment of interest, recording of royalties, research and development expenses, etc.
7. Method of stock-taking and its valuation including inventory policies.
8. System of budgetary control.
9. System of internal auditing.

(B) Verification of cost statements and other data

This will include the verification of:

(i) Licensed, installed and utilised capacities.
(ii) Financial ratios.
(iii) Production data.
(iv) Cost of raw material consumed, wages and salaries, stores, power and fuel, overheads, provision for depreciation etc.
(v) Sales realisation.
(vi) Abnormal, non-recurring and special costs.
(vii) Reconciliation with financial books.
COST AUDIT REPORT

Cost Audit Report means the report duly audited and signed by the cost auditor including attachment, annexure, qualifications or observations etc. to cost audit report.

Every cost auditor, who conducts an audit of the cost records of the company shall, within one hundred and eighty days from the close of the company’s financial year to which the report relates, submit the cost audit report along with his reservations or qualifications or observations or suggestions in the Form CRA-3 to the Board of Directors of the company.

ANNEXURE

COMPANIES (COST RECORD AND COST AUDIT) RULES, 2014

[To be published in the Gazette of India, Extraordinary, Part II, section 3, Sub-section (ii)].

Government of India

Ministry of Corporate Affairs

Notification,

New Delhi, 30th June, 2014

G.S.R.____ (E) - In exercise of the powers conferred by sub-sections (1) and (2) of section 469 and section 148 of the Companies Act, 2013 (18 of 2013) and in supersession of Companies (Cost Accounting Records) Rules, 2011; Companies (Cost Audit Report) Rules, 2011; Cost Accounting Records (Telecommunication Industry) Rules, 2011; Cost Accounting Records (Petroleum Industry) Rules, 2011; Cost Accounting Records (Electricity Industry) Rules, 2011; Cost Accounting Records (Sugar Industry) Rules, 2011; Cost Accounting Records (Fertilizer Industry) Rules, 2011 and Cost Accounting Records (Pharmaceutical Industry) Rules, 2011, except as respects things done or omitted to be done before such supersession, the Central Government hereby makes the following rules, namely:-

1. Short title and commencement.- (1) These rules may be called the Companies (cost records and audit) Rules, 2014.

(2) They shall come into force on the date of publication in the Official Gazette.

2. Definitions: In these rules, unless the context otherwise requires -

(a) “Act” means the Companies Act, 2013 (18 of 2013);

(b) “Cost Accountant in practice” means a cost accountant as defined in clause (b) of subsection (1) of section 2 of the Cost and Works Accountants Act, 1959 (23 of 1959), who holds a valid certificate of practice under sub-section (1) of section 6 of that Act and who is deemed to be in
practice under sub-section (2) of section 2 thereof, and includes a firm or limited liability partnership of cost accountants;

(c) “cost auditor” means a Cost Accountant in practice, as defined in clause (b), who is appointed by the Board;

(d) “cost audit report” means the report duly audited and signed by the cost auditor including attachment, annexure, qualifications or observations etc. to cost audit report;

(e) “cost records” means books of account relating to utilisation of materials, labour and other items of cost as applicable to the production of goods or provision of services as provided in section 148 of the Act and these rules;

(f) “form” means a form annexed to these rules;

(g) “institute” means the Institute of Cost Accountants of India constituted under the Cost and Works Accountants Act, 1959 (23 of 1959);

(h) all other words and expressions used in these rules but not defined, and defined in the Act or in the Companies (Specification of Definition Details) Rules, 2014 shall have the same meanings as assigned to them in the Act or in the said rules.

3. **Application of cost records.**— For the purpose of sub-section (1) of section 148 of the Act, the following class of companies, including Foreign Companies defined in sub-section (42) of section 2 of the Act, shall be required to include cost records in their books of account, namely:-

(A) Companies engaged in the production of following goods in strategic sectors, such as:

   (a) (i) machinery and mechanical appliances used in defence, space and atomic energy sectors excluding any ancillary item or items;

   Explanation: - For the purposes of this sub-clause, any company which is engaged in any item or items supplied exclusively for use under this clause, shall be deemed to be covered under these rules.

   (ii) turbo jets and turbo propellers;

   (iii) arms and ammunitions;

   (iv) propellant powders; prepared explosives, (other than propellant powders); safety fuses; detonating fuses; percussion or detonating caps; igniters; electric detonators;

   (v) radar apparatus, radio navigational aid apparatus and radio remote control apparatus;
(vi) tanks and other armoured fighting vehicles, motorised, whether or not fitted with weapons and parts of such vehicles, that are funded (investment made in the company) to the extent of ninety per cent. or more by the Government or Government Agencies;

(b) provisions of clause (A) shall be applicable, if the net worth of the company is rupees five hundred crore or more or the turnover is rupees five hundred crore or more.

(B) companies engaged in an industry regulated by a Sectoral Regulator or a Ministry or Department of Central Government:

(a) (i) Port services of stevedoring, pilotage, hauling, mooring, re-mooring, hooking, measuring, loading and unloading services rendered by a Port in relation to a vessel or goods regulated by the Tariff Authority for Major Ports under section 111 of the Major Port Trusts Act, 1963(38 of 1963);

(ii) Aeronautical services of air traffic management, aircraft operations, ground safety services, ground handling, cargo facilities and supplying fuel rendered by airports and regulated by the Airports Economic Regulatory Authority under the Airports Economic Regulatory Authority of India Act, 2008 (27 of 2008);

(iii) Telecommunication services made available to users by means of any transmission or reception of signs, signals, writing, images and sounds or intelligence of any nature (other than broadcasting services) and regulated by the Telecom Regulatory Authority of India under the Telecom Regulatory Authority of India Act, 1997 (24 of 1997);

(iv) Generation, transmission, distribution and supply of electricity regulated by the relevant regulatory body or authority under the Electricity Act, 2003 (36 of 2003), other than for captive generation (as defined under the Electricity Rules 2005);

(v) Steel;

(vi) Roads and other infrastructure projects;

(vii) Drugs and Pharmaceuticals;

(viii) Fertilisers;

(ix) Sugar and industrial alcohol;

(x) Petroleum products regulated by the Petroleum and Natural Gas Regulatory Board under the Petroleum and Natural Gas Regulatory Board Act, 2006(19 of 2006);

(xi) Rubber and allied products being regulated by the Rubber Board.

(b) For the purposes of clause (B), the thresholds limit shall be as under, -
(i) in the case of a multi-product or a multi services company (i.e. a company producing more than one product or service), any product or a service for which the individual turnover (from such specific product or such specific service) is rupees fifty crore or more;

(ii) in the case of a company, producing any one specific product or service, if the net worth of the company is rupees one hundred and fifty crore or more or the turnover is rupees twenty five crore or more.

(c) in the case of companies engaged in an industry regulated by a sectoral regulator, the requirements of sectoral regulator regarding cost records shall be taken into account.

(C) Companies operating in areas involving public interest such as:

(a) (i) Railway or tramway locomotives, rolling stock, railway or tramway fixtures and fittings, mechanical (including electro mechanical) traffic signalling equipment’s of all kind;

(ii) Mineral products including cement;

(iii) Ores;

(iv) Mineral fuels (other than Petroleum), mineral oils etc.;

(v) Base metals;

(vi) Inorganic chemicals, organic or inorganic compounds of precious metals, rare-earth metals of radioactive elements or isotopes, and Organic Chemicals;

(vii) Jute and Jute Products;

(viii) Edible Oil under Administrative Price Mechanism;

(ix) Construction Industry;

(x) Companies engaged in health services viz. functioning as or running hospitals, diagnostic centres, clinical centres or test laboratories;

(xi) Companies engaged in education services, other than such similar services falling under philanthropy or as part of social spend which do not form part of any business.

(b) For the purposes of clause (C), the thresholds limit shall be as under, -

(i) in the case of a multi-product or a multi services company (i.e. a company producing more than one product or service), any product or a service for which the individual turnover (from such specific product or such specific service) is rupees fifty crore or more;
(ii) in the case of a company producing any one specific product or service, if the net worth of the company is rupees one hundred and fifty crore or more or the turnover is rupees twenty five crore or more.

(D) Companies (including foreign companies other than those having only liaison offices) engaged in the production, import and supply or trading of following medical devices, namely:-

(a) (i) Cardiac Stents;
(ii) Drug Eluting Stents;
(iii) Catheters;
(iv) Intra Ocular Lenses;
(v) Bone Cements;
(vi) Heart Valves;
(vii) Orthopaedic Implants;
(viii) Internal Prosthetic Replacements;
(ix) Scalp Vein Set;
(x) Deep Brain Stimulator;
(xi) Ventricular peripheral Shud;
(xii) Spinal Implants;
(xiii) Automatic Impalpable Cardiac Deflobillator;
(xiv) Pacemaker (temporary and permanent);
(xv) patent ductus arteriosus, atrial septal defect and ventricular septal defect closure device;
(xvi) Cardiac Re-synchronize Therapy ;
(xvii) Urethra Spinicture Devices;
(xviii) Sling male or female;
(xix) Prostate occlusion device; and
(xx) Urethral Stents.

(b) For the purposes of clause (D), the thresholds limit shall be as under, -
(i) in the case of a company engaged in multiple products, any product or device for which the individual turnover (from such specific product or device) is rupees ten crore or more, or one third of the turnover, whichever is less.

(ii) in the case of a company engaged in one specific product or device, if it has net worth of rupees one hundred and fifty crore or more or the turnover is rupees twenty five crores or more;

4. Applicability for cost audit.-

(1) Every company engaged in a strategic industry and covered under sub-clause (b) of clause (A) of rule 3 shall be required to get its cost records audited in accordance with these rules.

(2) In the case of a multi-product or a multi services company specified in sub-clause (b) of clause (B) and sub-clause (b) of clause (C) of rule 3, the requirement for cost audit shall apply to a product or a service for which the individual turnover (from such specific product or such specific service) is rupees one hundred crore or more;

(3) In the case of a company producing any one specific product or service specified in subclause (b) of clause (B) and sub-clause (b) of clause (C) of rule 3, the requirement for cost audit shall apply if the net worth of the company is rupees five hundred crore or more or the turnover from such product or such service is rupees one hundred crore or more.

(4) In the case of a company engaged in medical products or devices referred to in subclause (b) of clause (D) of rule 3, -

(i) which has multiple products or devices (i.e. a company producing, importing and supplying or trading in more than one medical device or product), the requirement for cost audit shall apply to a medical device or product for which the individual turnover (from such specific medical device or product) is rupees ten crore or more, or one third of the turnover, whichever is less;

(ii) which has only one product or device (i.e. a company producing, importing and supplying or trading one medical device or product), the requirement for cost audit shall apply if the net worth of the company is rupees one hundred fifty crores or more or the turnover is rupees twenty five crores or more.

5. Maintenance of records.- (1) Every company under these rules including all units and branches thereof, shall, in respect of each of its financial year commencing on or after the 1st day of April, 2014, maintain cost records in form CRA-1.

(2) The cost records referred to in sub-rule (1) shall be maintained on regular basis in such manner as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and
margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.

(3) The cost records shall be maintained in such manner so as to enable the company to exercise, as far as possible, control over the various operations and costs to achieve optimum economies in utilisation of resources and these records shall also provide necessary data which is required to be furnished under these rules.

6. Cost audit.- (1) The category of companies specified in rule 3 and the thresholds limits laid down in rule 4, shall within one hundred and eighty days of the commencement of every financial year, appoint a cost auditor.

(2) Every company referred to in sub-rule (1) shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of thirty days of the Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in form CRA-2, alongwith the fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

(3) Every cost auditor appointed as such shall continue in such capacity till the expiry of one hundred and eighty days from the closure of the financial year or till he submits the cost audit report, for the financial year for which he has been appointed.

(4) Every cost auditor, who conducts an audit of the cost records of a company, shall submit the cost audit report along with his or its reservations or qualifications or observations or suggestions, if any, in form CRA-3.

(5) Every cost auditor shall forward his report to the Board of Directors of the company within a period of one hundred and eighty days from the closure of the financial year to which the report relates and the Board of directors shall consider and examine such report particularly any reservation or qualification contained therein.

(6) Every company covered under these rules shall, within a period of thirty days from the date of receipt of a copy of the cost audit report, furnish the Central Government with such report alongwith full information and explanation on every reservation or qualification contained therein, in form CRA-4 alongwith fees specified in the Companies (Registration Offices and Fees) Rules, 2014.

(7) The provisions of sub-section (12) of section 143 of the Act and the relevant rules made thereunder shall apply mutatis mutandis to a cost auditor during performance of his functions under section 148 of the Act and these rules.

7. Rules not to apply in certain cases.- The requirement for cost audit under these rules shall not be applicable to a company which is covered under rule 3, and,
(i) whose revenue from exports, in foreign exchange, exceeds seventy five per cent of its total revenue or

(ii) which is operating from a special economic zone.

**LESSON ROUND UP**

Cost audit involves checking up the arithmetical accuracy of cost accounts and verifying whether the principles laid down have been followed or not.

Cost audit detects and prevents errors and frauds in preparation of cost records.

The auditing of cost accounts acts as an effective tool in the hands of management for the detection of errors, frauds, inconsistencies and irregularities.

Audited cost accounts are helpful in making inter-firm comparison.

Section 148 of the Companies Act, 2013 deals with the audit of Cost Accounting records.

**SELF TEST QUESTIONS**

1. What do you mean by Cost Audit?
2. What are the rights and responsibilities of a Cost Auditor?
3. State the provisions of the Companies Act, 2013 with respect to Audit of Cost Accounts.
4. Write short notes on:
   (a) Scope of Cost Audit
   (b) Purpose of Cost Audit
   (c) Advantages of Cost Audit
   (d) Responsibilities of Cost Auditor
   (e) Appointment of Cost Auditor
   (f) Cost Audit Programme
   (g) Cost Audit Report
EXECUTIVE PROGRAMME

TAX LAWS
AND PRACTICE

MODULE I- PAPER 4
Students appearing in December 2014 Examination shall note that all changes made by Finance Act, 2013 in Service Tax Laws and all the relevant Circulars, Clarifications/Notifications issued by CBEC / Central Government effective six months prior to the date of examination are applicable.

These notifications and circulars are for Service tax which is updated upto 30th June, 2014.
Notifications in Service Tax

1. Notification No. 01/2014 - Service Tax, dated 10.01.2014: amendment of notification no. 25/2012- Service Tax (Mega Exemption Notification), Dated the 20.06.2012

In the said notification, in the opening paragraph, in entry 11, in item (a), for the words “district, State or zone”, the words “district, State, zone or Country” shall be substituted.


In the said notification, in the paragraph 2, for clause (s), the following shall be substituted, namely:–

‘(s) “governmental authority” means an authority or a board or any other body;
(i) set up by an Act of Parliament or a State Legislature; or
(ii) established by Government,
with 90% or more participation by way of equity or control, to carry out any function entrusted to a municipality under article 243W of the Constitution;’.

3. Notification No. 03/2014 - Service Tax, dated 3.02.2014: Regarding levy of service tax on services provided by an authorised person or sub-brokers to the member of a commodity exchange.

G.S.R….(E).- Whereas, the Central Government is satisfied that a practice was generally prevalent regarding levy of service tax (including non-levy thereof), under section 66 of the Finance Act, 1994 (32 of 1994) (hereinafter referred to as ‘the Finance Act’), on services provided by an authorised person or sub-broker to the member of a recognised association or a registered association, in relation to a forward contract, and that such services were liable to service tax under the Finance Act, which was not being levied according to the said practice during the period commencing from the 10th day of September 2004 and ending with the 30th day of June 2012;

Now, therefore, in exercise of the powers conferred by section 11C of the Central Excise Act, 1944 (1 of 1944), read with section 83 of the Finance Act, the Central Government hereby directs that the service tax payable on the services provided by an authorised person or sub-broker to the member of a recognised association or a registered association, in relation to a forward contract, shall not be required to be paid in respect of such taxable service on which the service tax was not being levied during the aforesaid period in accordance with the said practice.

In the said notification, in the opening paragraph,-

(i) after entry 2, the following entry shall be inserted, namely:-
“2A. Services provided by cord blood banks by way of preservation of stem cells or any other service in relation to such preservation;”;

(ii) after entry 39, the following entry shall be inserted, namely:-
“40. Services by way of loading, unloading, packing, storage or warehousing of rice.”.

Circulars in Service Tax

1. Circular No.175 /01 /2014 – ST, dated 10.01. 2014: Regarding Levy of service tax on services provided by a Resident Welfare Association (RWA) to its own members

Service tax on ‘club or association service’ which covers Resident Welfare Association (RWA) was introduced with effect from 16.06.2005, vide section 65(105)(zzze) read with section 65(25a)((25a) was later renumbered as (25aa)). Under the positive list approach which was followed prior to 1st July 2012, exemption was available under notification No. 8/2007-ST dated 01.03.2007, if the total consideration received from an individual member by the RWA for the services does not exceed three thousand rupees per month. This notification was rescinded vide notification No. 34/2012-ST dated 20th June 2012, with effect from 1st July, 2012.

Under the negative list approach, with effect from 1st July, 2012, notification No.25/2012-ST [sl.no.28 (c)] provides for exemption to service by a RWA to its own members by way of reimbursement of charges or share of contribution up to five thousand rupees per month per member for sourcing of goods or services from a third person for the common use of its members.

Certain doubts have been raised regarding the scope of the present exemption extended to RWAs under the negative list approach. These doubts have been examined and clarifications are given below:

<table>
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<tr>
<th>Sl. No.</th>
<th>Doubt</th>
<th>Clarification</th>
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<tbody>
<tr>
<td>1.</td>
<td>(i) In a residential complex, monthly contribution collected from members is used by the RWA for the purpose of making payments to the third parties, in respect of commonly used services or goods [Example: for providing security service for the residential complex, maintenance or upkeep of common area and common facilities like lift, water sump, health and</td>
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<td>Exemption at Sl. No. 28 (c) in notification No. 25/2012-ST is provided specifically with reference to service provided by an unincorporated body or a non–profit entity registered under any law for the time being in force such as RWAs, to its own members.</td>
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<td>However, a monetary ceiling has been prescribed for this exemption, calculated in the form of five thousand rupees per month</td>
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</table>
| 1. | (i) Is service tax leviable?  
   (ii) If the contribution of a member/s of a RWA exceeds five thousand rupees per month, how should the service tax liability be calculated? |
|   | fitness centre, swimming pool, payment of electricity Bill for the common area and lift, etc.]. Is service tax leviable?  
   If per month per member contribution of any or some members of a RWA exceeds five thousand rupees, the entire contribution of such members whose per month contribution exceeds five thousand rupees would be ineligible for the exemption under the said notification. Service tax would then be leviable on the aggregate amount of monthly contribution of such members. |
| 2. | (i) Is threshold exemption under notification No. 33/2012-ST available to RWA?  
   (ii) Does ‘aggregate value’ for the purpose of threshold exemption, include the value of exempt service? |
|   | Threshold exemption available under notification No. 33/2012-ST is applicable to a RWA, subject to conditions prescribed in the notification. Under this notification, taxable services of aggregate value not exceeding ten lakh rupees in any financial year is exempted from service tax. As per the definition of ‘aggregate value’ provided in Explanation B of the notification, aggregate value does not include the value of services which are exempt from service tax. |
| 3. | If a RWA provides certain services such as payment of electricity or water bill issued by third person, in the name of its members, acting as a ‘pure agent’ of its members, is exclusion from value of taxable service available for the purposes of exemptions provided in Notification 33/2012-ST or 25/2012-ST? |
|   | In Rule 5(2) of the Service Tax (Determination of Value) Rules, 2006, it is provided that expenditure or costs incurred by a service provider as a pure agent of the recipient of service shall be excluded from the value of taxable service, subject to the conditions specified in the Rule.  
   For illustration, where the payment for an electricity bill raised by an electricity transmission or distribution utility in the name of the owner of an apartment in respect of electricity consumed thereon, is collected and paid by the RWA to the utility, without charging any commission or a consideration by any other name, the RWA is acting as a pure agent and hence exclusion from the value of taxable service would be available. However, in the case of electricity bills issued in the name of RWA, in respect of electricity consumed for common use of
lifts, motor pumps for water supply, lights in common area, etc., since there is no agent involved in these transactions, the exclusion from the value of taxable service would not be available.

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<th>4. Is CENVAT credit available to RWA for payment of service tax?</th>
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<td></td>
<td>RWA may avail cenvat credit and use the same for payment of service tax, in accordance with the Cenvat Credit Rules.</td>
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</table>

2. Circular No.177/03/2014 – ST, dated 17.02.2014: Regarding Rice – exemptions from service tax

Doubts have been raised regarding the scope and applicability of various exemptions available to various activities in relation to rice, under the negative list approach. These doubts have been examined and clarifications are given below:

2. These doubts have arisen in the context of definition of ‘agricultural produce’ available in section 65B(5) of the Finance Act, 1994. The said definition covers ‘paddy’; but excludes ‘rice’. However, many benefits available to agricultural produce in the negative list [section 66D(d)] have been extended to rice, by way of appropriate entries in the exemption notification.

3. **Transportation of rice:**
   3.1 by a rail or a vessel: Services by way of transportation of food stuff by rail or a vessel from one place in India to another is exempt from service tax vide exemption notification 25/2012-ST dated 20th June, 2012 [entry sl.no.20(i)]; food stuff includes rice.
   3.2 by a goods transport agency: Transportation of food stuff by a goods transport agency is exempt from levy of service tax [exemption notification 25/2012-ST dated 20th June, 2012 [entry sl.no.21(d)]; amending notification 3/2013-ST dated 1st March 2013]. Food stuff includes rice.

4. **Loading, unloading, packing, storage and warehousing of rice:** Exemption has been inserted in the exemption notification 25/2012-ST dated 20th June, 2012 [entry sl.no.40]; amending notification 4/2014-ST dated 17th February 2014 may be referred.

5. **Milling of paddy into rice:** When paddy is milled into rice, on job work basis, service tax is exempt under sl.no.30 (a) of exemption notification 25/2012-ST dated 20th June, 2012, since such milling of paddy is an intermediate production process in relation to agriculture.

**********
EXECUTIVE PROGRAMME

COMPANY ACCOUNTS
AND AUDITING
PRACTICES

MODULE II- PAPER 5
LESSON 1: SHARE CAPITAL

ISSUE OF SHARES

Meaning of shares
A share is one unit into which the total share capital is divided. Each share forms a unit of ownership and is offered for sale so as to raise capital for the company. The shares any member in a company are movable property transferable in the manner provided by the articles of the company. Face value of a share is the par value of the share. It is also known as the Nominal value or denomination of a share.

According to Section 2(84) of the Companies Act 2013, “share” means a share in the share capital of a company and includes stock. Thus, in other words, shares are divisions of the share capital of a company. A share represents a fractional part of the share capital of the company. For example, if a company has a share capital of Rs. 5,00,000 divided into 50,000 shares of Rs.10 each and a person who has taken 50 shares of the company is said to have a share of Rs. 500 in the share capital of the company.

Meaning of share capital
When total capital of a company is divided into shares, then it is called share capital. A joint stock company raises its capital by issue of shares to finance its activities. The Memorandum of Association of the company states the amount of capital with which the company is desired to be registered and the number of shares into which it is to be divided. It constitutes the basis of the capital structure of a company.

Kinds of share capital
The share capital of a company limited by shares shall be of two kinds under the Companies Act 2013, namely:

(a) Equity share capital: Equity share capital with reference to any company limited by shares means all share capital which is not preference share capital. Equity share capital can be
i) with voting rights; or
ii) with differential rights as to dividend or voting or any other right.

(b) Preference share capital: Preference share capital with reference to any company limited by shares means that part of the issued share capital of the company which carries or would carry a preferential right with respect to—

- payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and
- repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company.

Deemed preference share capital: The capital shall be deemed to be preference capital, notwithstanding that it is entitled to either or both of the following rights, namely:
• that in respect of dividends, in addition to the preferential rights to the payment of dividend, it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;
• that in respect of capital, in addition to the preferential right to the repayment, on a winding up, it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

Voting rights on preference shares
2013 Act provides that where a dividend in respect of a class of preferences shares has not been paid for a period of 2 years or more, such class of preferences shareholders shall have a right to vote on all the resolutions placed before a general meeting of the company. This is irrespective of whether the preferences shares are cumulative or non-cumulative. Thus, unlike 1956 Act, 2013 Act makes no distinction between cumulative preferences shares and non-cumulative preferences shares in the matter of the voting rights in the event of non-payment of dividend.

 Shares with differential rights
The provisions relating to issue of shares with differential rights as to dividend, voting or otherwise have been retained in 2013 Act.

Issue of Shares at Discount
• When shares are issued at a price lower than the face value, they are said to be issued at discount. Thus, the excess of the face value over the issue price is the amount of discount. For example, if a share of ₹ 10 is issued at ₹ 9 then ₹ (10 – 9) = Re. 1 is the discount.
• As per companies Act 2013, a company shall not issue shares at a discount except as provided in section 54 for issue of sweat equity shares. Any share issued by a company at a discounted price shall be void.
• Where a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.
• 1956 Act permitted issue of shares at a discount to its par value subject to conditions. 2013 Act prohibits issue of shares at a discount except in case of "sweat equity shares" issued to the employees of the Company – "sweat equity shares" means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

UTILIZATION OF SECURITIES PREMIUM
Securities premium may be applied for permitted purposes. Utilization of securities premium for any other purpose would entail compliance with provisions relating to reduction of capital. For classes of companies to be prescribed in the Rules, utilization of securities premium for the following purposes will require such a company to ensure that the Accounting Standards prescribed have been complied:
• Issue of bonus equity shares
• Writing off the expenses of or the commission paid on any issue of equity shares
• Buy-back of shares or other securities

INTEREST ON CALLS-IN-ADVANCE
The amount received as calls-in-advance is a debt of the company, the company is liable to pay interest on the amount of Calls-in-Advance from the date of receipt of the amount till the date when the call is due for payment. Generally the Articles of the company specify the rate at which interest is payable. If the articles do not contain such rate, Table F of the Companies Act 2013 will be applicable which leaves the matter to the Board of directors subject to a maximum rate of 12% p.a. It is to be noted that the interest payable on Calls-in-Advance is a charge against the profits of the company. As such, Interest on Calls-in-Advance must be paid even when no profit is earned by the company.

INTEREST ON CALLS IN ARREAR
The interest on Calls-in-Arrear is recoverable according to the provisions in this regard in Articles of the company. But if the Articles are silent, Table ‘F’ of Schedule I of the Companies Act 2013, shall be applicable which prescribes that if a sum called in respect of shares is not paid before or on the day appointed for payment, the person who failed to pay shall pay thereof from the day appointed for payment to the time of actual payment at a rate not exceeding 10% per annum. However, the directors have the right to waive the payment of interest on Calls-in-Arrear. The interest on Calls-on-Arrear Account is transferred to the Profit and Loss Account at the end of the year.

BUY-BACK OF SHARES
When a company has substantial cash resources, it may like to buy its own shares from the market particularly when the prevailing rate of its shares in the market is much lower than the book value or what the company perceives to be its true value. Buy back of shares enables the company to go back to its shareholders and offers to purchase from them the shares they hold. Buy Back of Securities is a very important tool for Companies who wants to reduce their Share Capital.

Advantages of Buy Back:
• It is an alternative mode of reduction in capital without requiring approval of the Court/CLB(NCLT),
• to improve the earnings per share;
• to improve return on capital, return on net worth and to enhance the long-term shareholders value;
• to provide an additional exit route to shareholders when shares are undervalued or thinly traded;
• to enhance consolidation of stake in the company;
• to prevent unwelcome takeover bids;
• to return surplus cash to shareholders;
• to achieve optimum capital structure;
• to support share price during periods of sluggish market condition;
• to serve the equity more efficiently.
Sections 68, 69 and 70 of Companies Act, 2013 provides for buy back of shares.

According to section 68(1) of the Companies Act 2013, a company may purchase its own shares or other specified securities (referred to as buy-back) out of—

(a) its free reserves;
(b) the securities premium account; or
(c) the proceeds of the issue of any shares or other specified securities:

However, no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

**Conditions for buy back:**

According to section 68(2), following conditions must be satisfied in order to buy-back the shares.

i) must be authorized by its articles;

ii) a special resolution has been passed at a general meeting of the company authorizing the buy-back, but the same is not required when:
   i) the buy-back is 10% or less of the total paid-up equity capital and free reserves of the company; and
   ii) such buy-back has been authorized by the Board by means of a resolution passed at its meeting;

iii) the buy-back is twenty-five per cent or less of the aggregate of paid-up capital and free reserves of the company. But in case of Equity Shares, the same shall be taken as 25% of paid up equity capital only.

iv) Debt equity ratio should be 2:1, where: Debt is aggregate of secured and unsecured debts owed by the after buy-back and Equity: is aggregate of the paid-up capital and its free reserves:

v) all the shares or other specified securities for buy-back are fully paid-up;

vi) If shares or securities are listed, buy back will be in accordance with the regulations made by the Securities and Exchange Board in this behalf; and

vii) the buy-back in respect of unlisted shares or other specified securities is in accordance with Share Capital and Debentures Rules, 2014.

viii) No offer of buy-back shall be made within a period of one year from the date of the closure of the preceding offer of buy-back, if any.

**Explanatory Statement - Section 68(3):**

The notice of the meeting at which the special resolution is proposed to be passed shall be accompanied by an explanatory statement stating—

a) a full and complete disclosure of all material facts;

b) the necessity for the buy-back;

c) the class of shares or securities intended to be purchased under the buy-back;

d) the amount to be invested under the buy-back; and

e) the time-limit for completion of buy-back.

As per the rules, following more details is to be included in the Explanatory Statement:

f) the date of the board meeting at which the proposal for buy-back was approved by the board of directors of the company;
g) the number of securities that the company proposes to buy-back;

h) the method to be adopted for the buy-back;

i) the price at which the buy-back of shares or other securities shall be made;

j) the basis of arriving at the buy-back price;

k) the maximum amount to be paid for the buy-back and the sources of funds from which the buy-back would be financed;

l) Shareholding:
   i) the aggregate shareholding of the promoters and of the directors of the promoter, where the promoter is a company and of the directors and key managerial personnel as on the date of the notice convening the general meeting;
   ii) the aggregate number of equity shares purchased or sold by persons mentioned in sub-clause (i) during a period of twelve months preceding the date of the board meeting at which the buy-back was approved and from that date till the date of notice convening the general meeting;
   iii) the maximum and minimum price at which purchases and sales referred to in sub-clause (ii) were made along with the relevant date;

m) if the persons mentioned in l(i) intend to tender their shares for buy-back –
   i) the quantum of shares proposed to be tendered;
   ii) the details of their transactions and their holdings for the last twelve months prior to the date of the board meeting at which the buy-back was approved including information of number of shares acquired, the price and the date of acquisition;

n) a confirmation that there are no defaults subsisting in repayment of deposits, interest payment thereon, redemption of debentures or payment of interest thereon or redemption of preference shares or payment of dividend due to any shareholder, or repayment of any term loans or interest payable thereon to any financial institution or banking company;

o) a confirmation:
   i) that the Board of directors have made a full enquiry into the affairs and prospects of the company and that they have formed the opinion- general meeting is convened there shall be no grounds on which the company could be found unable to pay its debts;
   ii) as regards its prospects for the year immediately following that date, that, having regard to their intentions with respect to the management of the company’s business during that year and to the amount and character of the financial resources which will in their view be available to the company during that year, the company shall be able to meet its liabilities as and when they fall due and shall not be rendered insolvent within a period of 1 year from that date; and
   iii) the directors have taken into account the liabilities (including prospective and contingent liabilities), as if the company were being wound up under the provisions of the Companies Act, 2013

p) a report addressed to the Board of directors by the company’s auditors stating that-
i) they have inquired into the company’s state of affairs;
ii) the amount of the permissible capital payment for the securities in question is in their view properly determined;
iii) that the audited accounts on the basis of which calculation with reference to buy back is done is not more than six months old from the date of offer document; and
iv) the Board of directors have formed the opinion as specified in point ‘o’ on reasonable grounds and that the company, having regard to its state of affairs, shall not be rendered insolvent within a period of one year from that date.

**Other Conditions for Buy back**

- Every buy-back shall be completed within a period of one year from the date of passing of the special resolution, or as the case may be, the resolution passed by the Board. **Section 68(4)**

- The buy-back can be from:
  a) from the existing shareholders or security holders on a proportionate basis;
  b) from the open market;
  c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity. **Section 68(5)**

- Before making such buy-back, file with the Registrar, a declaration of solvency signed by at least two directors of the company, one of whom shall be the managing director, if any, Form No. SH.9 may be prescribed and verified by an affidavit to the effect that the Board of Directors of the company has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year from the date of declaration adopted by the Board **Section 68(6)**.

- Company shall extinguish and physically destroy the shares or securities so bought back within seven days of the last date of completion of buy-back **Section 68(7)**.

- Where a company completes a buy-back of its shares or other specified securities, it shall not make a further issue of the same kind of shares or other securities including allotment of new shares or other specified securities within a period of six months except by way of:
  a) a bonus issue or
  b) in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.

- Company shall maintain a register in Form No. SH.10 of the shares or securities so bought, the consideration paid for the shares or securities bought back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities. The register of shares or securities bought-back shall be maintained at the registered office of the company and shall be kept in the custody of the secretary of the
company or any other person authorized by the board in this behalf. The entries in the register shall be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose.

- A company shall, after the completion of the buy-back under this section, file with the Registrar a return in Form No. SH.11 containing such particulars relating to the buy-back within thirty days of such completion. There shall be annexed to the return, a certificate in Form No. SH.15 signed by two directors of the company including the managing director, if any, certifying that the buy-back of securities has been made in compliance with the provisions of the Act and the rules made thereunder.

- If a company makes any default in complying with the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

Transfer of certain sums to capital redemption reserves account (section 69)

Where a company purchases its own shares out of free reserves or securities premium account, a sum equal to the nominal value of the shares so purchased shall be transferred to the capital redemption reserve account and details of such transfer shall be disclosed in the balance sheet. The capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Prohibition on buy back in following circumstances: (section 70)

No company shall directly or indirectly purchase its own shares or other specified securities—

a) through any subsidiary company including its own subsidiary companies;

b) through any investment company or group of investment companies; or

c) if a default, is made by the company, in the repayment of deposits accepted either before or after the commencement of this Act, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company. Provided that the buy-back is not prohibited, if the default is remedied and a period of three years has lapsed after such default ceased to subsist.

No company shall, directly or indirectly, purchase its own shares or other specified securities in case such company has not complied with the provisions of:

a) Sections 92: Annual Return

b) Section 123: Declaration and Payment of Dividend

c) Section 127: Failure to pay Dividend

d) Section 129: Failure to give True and Fair Statement

ISSUE OF BONUS SHARES

Unlike 1956 Act, conditions are specified for issue of Bonus shares under 2013 Act which are made applicable to all companies. Accordingly, issue of fully paid-up bonus shares can be made out of its free reserves or the securities premium account or capital redemption reserve.
account. However, company cannot issue bonus shares by capitalizing revaluation reserves.

According to Section 63 of the Companies Act 2013, a company may issue fully paid-up bonus shares to its members, in any manner out of—

i. its free reserves;
ii. the securities premium account; or
iii. the capital redemption reserve account.

However, no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

No company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares unless—

a) it is authorised by its articles;
b) it has, on the recommendation of the Board, been authorised in the general meeting of the company;
c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
d) it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
e) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;
f) The company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same. (rule 14 of Companies (share capital and debentures) rules, 2014)

The bonus shares shall not be issued in lieu of dividend.

FURTHER ISSUE OF CAPITAL

Provisions relating to further issue of capital are made applicable to all types of companies i.e. even private companies have to comply with these provisions for any further issue of capital. This extension to private companies is to ensure that the shareholders are consulted and their opinion considered for issue of shares by special resolution. Pricing of a preferential issue of shares by a company shall be determined by a Registered Valuer.

Amounts received as share application money by private companies also will not be available for use until it allotment of shares Shelf prospectus (i.e. prospectus in respect of which securities are issued for subscription in one or more issues without the issue of a further prospectus) can be issued by classes of companies to be prescribed by Regulations of SEBI.

EMPLOYEE STOCK OPTION SCHEME

**Meaning:** As per section 2(37) of the Companies Act, 2013 “employees’ stock option” means the option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price. ESOP or employee stock option plan refers to a basket of instruments and incentive schemes that find favour with the new upward mobile salary class and which are used to motivate, reward, remunerate and hold on to achievers.
**Issue Of Employee Stock Options:** A company, other than a listed company, which is not required to comply with Securities and Exchange Board of India Employee Stock Option Scheme Guidelines, shall offer shares to its employees under this scheme after complying of following requirements:

The issue of Employees Stock Option Scheme has been approved by the shareholders of the company by passing a special resolution. For the purpose of above statement the word “Employee” means a permanent employee of the company who has been working in India or outside India; or a director of the company, but excluding an independent director; or an employee as defined in 1(a) or (b) above of a subsidiary, in India or outside India, or of a holding company of the company or of an associate company, excluding-

(a) an employee who is a promoter or a person belonging to the promoter group; or
(b) a director who either himself or through his relative or through any body-corporate, directly or indirectly, holds more than ten percent of the outstanding equity shares of the company.

The company shall make the following disclosures in the explanatory statement annexed to the notice for passing of the resolution-

a) the total number of stock options to be granted;

b) identification of classes of employees entitled to participate in the ESOP;

c) the appraisal process for determining the eligibility of employees to the ESOP;

d) the requirements of vesting and period of vesting;

e) the maximum period within which the options shall be vested;

f) the exercise price or the formula for arriving at the same;

(g) the exercise period and process of exercise;

h) the Lock-in period, if any;

i) the maximum number of options to be granted per employee and in aggregate

j) the method which the company shall use to value its options;

k) the conditions under which option vested in employees may lapse e.g. in case of termination of employment for misconduct;

l) the specified time period within which the employee shall exercise the vested options in the event of a proposed termination of employment or resignation of employee; and

m) a statement to the effect that the company shall comply with the applicable accounting standards.

The companies granting option to its employees pursuant to Employees Stock Option Scheme will have the freedom to determine the exercise price in conformity with the applicable accounting policies, if any.

The approval of shareholders by way of separate resolution shall be obtained by the company in case of-

a) grant of option to employees of subsidiary or holding company; or

b) grant of option to identified employees, during any one year, equal to or exceeding one percent of the issued capital of the company at the time of grant of option.
The company may by special resolution, vary the terms of ESOP not yet exercised by the employees. The notice for passing special resolution for variation of terms of ESOP shall disclose full details of the variation, the rationale therefore, and the details of the employees who are beneficiaries of such variation.

There shall be a minimum period of one year between the grant of options and vesting of option. However, in a case where options are granted by a company under its Employees Stock Option Scheme in lieu of options held by the same person under an Employees Stock Option Scheme in another company, which has merged or amalgamated with the first mentioned company, the period during which the options granted by the merging or amalgamating company were held by him shall be adjusted against the minimum vesting period required (i.e; 1 year)

(a) The company shall have the freedom to specify the lock-in period for the shares issued pursuant to exercise of option.

(b) The Employees shall not have right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to them, till shares are issued on exercise of option.

The amount, payable by the employees, at the time of grant of option-

a) may be forfeited by the company if the option is not exercised by the employees within the exercise period; or

b) the amount may be refunded to the employees if the options are not vested due to non-fulfillment of conditions relating to vesting of option as per the Employees Stock Option Scheme.

**Other Conditions**

(a) The option granted to employees shall not be transferable.

(b) The option granted to the employees shall not be pledged, hypothecated, mortgaged or otherwise encumbered or alienated in any other manner.

(c) Subject to clause (d), no person other than the employees to whom the option is granted shall be entitled to exercise the option.

(d) In the event of the death of employee while in employment, all the options granted to him till such date shall vest in the legal heirs or nominees of the deceased employee.

(e) In case the employee suffers a permanent incapacity while in employment, all the options granted to him as on the date of permanent incapacitation, shall vest in him on that day.

(f) In the event of resignation or termination of employment, all options not vested in the employee as on that day shall expire. However, the employee can exercise the options granted to him which are vested within the period specified in this behalf, subject to the terms and conditions under the scheme granting such options as approved by the Board.

The Board of directors, shall, inter alia, disclose in the Directors’ Report for the year, the following details of the Employees Stock Option Scheme:

(a) options granted;

(b) options vested;

(c) options exercised;
(d) the total number of shares arising as a result of exercise of option;
(e) options lapsed;
(f) the exercise price;
(g) variation of terms of options;
(h) money realized by exercise of options;
(i) total number of options in force;
(j) employee wise details of options granted to—
   i) key managerial personnel;
   ii) any other employee who receives a grant of options in any one year of option
costing to five percent or more of options granted during that year.
   iii) identified employees who were granted option, during any one year, equal to or
exceeding one percent of the issued capital (excluding outstanding warrants and
conversions) of the company at the time of grant;

The company shall maintain a Register of Employee Stock Options in Form No. SH.6 and shall
forthwith enter therein the particulars of option granted to employees under a scheme of ESOP
subject to above conditions. The Register of Employee Stock Options shall be maintained at the
registered office of the company or such other place as the Board may decide. The entries in the
register shall be authenticated by the company secretary of the company or by any other person
authorized by the Board for the purpose.

Where the equity shares of the company are listed on a recognized stock exchange, the Employees
Stock Option Scheme shall be issued, in accordance with the regulations made by the Securities
and Exchange Board of India in this behalf.

ISSUE OF SWEAT EQUITY SHARES
Notwithstanding anything contained in section 53, a company may issue sweat equity shares of a
class of shares already issued, if the following conditions are fulfilled, namely:—
(a) the issue is authorised by a special resolution passed by the company;
(b) the resolution specifies the number of shares, the current market price, consideration, if
any, and the class or classes of directors or employees to whom such equity shares are to be
issued;
(c) not less than one year has, at the date of such issue, elapsed since the date on which the
company had commenced business; and
(d) where the equity shares of the company are listed on a recognised stock exchange, the
sweat equity shares are issued in accordance with the regulations made by the Securities
and Exchange Board in this behalf and if they are not so listed, the sweat equity shares
are issued in accordance with such rules as may be prescribed.

The rights, limitations, restrictions and provisions as are for the time being applicable to equity
shares shall be applicable to the sweat equity shares issued under this section and the holders of
such shares shall rank pari passu with other equity shareholders.

RIGHT SHARES
Where at any time, a company having a share capital proposes to increase its subscribed capital by
the issue of further shares, such shares shall be offered—
(a) to persons who, at the date of the offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid-up share capital on those shares by sending a letter of offer subject to the following conditions, namely:—

i) the offer shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;

ii) unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice referred to in clause (i) shall contain a statement of this right;

iii) after the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner which is not dis-advantageous to the shareholders and the company;

(b) to employees under a scheme of employees’ stock option, subject to special resolution passed by company and subject to such conditions as may be prescribed; or

(c) to any persons, if it is authorised by a special resolution, whether or not those persons include the persons referred to in clause (a) or clause (b), either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.

The notice referred to in sub-clause (i) of clause (a) of sub-section (1) shall be despatched through registered post or speed post or through electronic mode to all the existing shareholders at least three days before the opening of the issue.

Nothing in this section shall apply to the increase of the subscribed capital of a company caused by the exercise of an option as a term attached to the debentures issued or loan raised by the company to convert such debentures or loans into shares in the company: Provided that the terms of issue of such debentures or loan containing such an option have been approved before the issue of such debentures or the raising of loan by a special resolution passed by the company in general meeting.
ISSUE OF PREFERENCE SHARES

Introduction
A company limited by shares may, if so authorised by its articles, issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue under section 55 of the Companies Act 2013. No company limited by shares shall, can issue any preference shares which are irredeemable.
A company may issue preference shares for a period exceeding 20 years but not exceeding 30 years for infrastructure projects (Specified in Schedule VI). However, it is subject to redemption of minimum 10% of such preference shares per year from the twenty-first year onwards or earlier, on proportionate basis, at the option of the preference shareholders.

Redemption of preference shares
The preference shares can be redeemed only when they are fully paid up-
- out of the profits of the company which would otherwise be available for dividend or
- out of the proceeds of a fresh issue of shares made for the purposes of such redemption.

Capital Redemption Reserve Account
If preference shares are proposed to be redeemed out of the profits of the company, a sum equal to the nominal amount of the shares to be redeemed, shall be transferred to a reserve called the Capital Redemption Reserve Account out of the profits of the company and the provisions of this Act relating to reduction of share capital of a company shall apply as if the Capital Redemption Reserve Account were paid-up share capital of the company.
The capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Premium on redemption of preference shares
a) For the companies whose financial statements comply with the accounting standards as prescribed under section 133, the premium payable on redemption shall be provided out of the profits of the company, before the shares are redeemed.

b) For redemption of any preference shares issued on or before the commencement of 2013 Act, the premium payable on redemption shall be provided out of the profits of the company, or out of the company’s securities premium account, before such shares are redeemed.

c) For the companies whose financial statements need not comply with the accounting standards as prescribed under section 133, the premium payable on redemption shall be provided out of the profits of the company, or out of the company’s securities premium account, before such shares are redeemed.
UNDERWRITING OF SHARES

Underwriting Commission
The consideration payable to the underwriters for underwriting the issue of shares or debentures of a company is called underwriting commission. Such a commission is paid at a specified rate on the issue price of the whole of the shares or debentures underwritten whether or not the underwriters are called upon to take up any shares or debentures. Thus, the underwriters are paid for the risk they bear in the placing of shares before the public. Underwriting commission may be in addition to brokerage.

Payment of Underwriting Commission
Section 40 (6) of the Companies Act 2013, provides that a company may pay commission to any person in connection with the subscription or procurement of subscription to its securities, whether absolute or conditional, subject to the following conditions which are prescribed under Companies (Prospectus and Allotment of Securities) Rules, 2014:
(a) the payment of such commission shall be authorized in the company’s articles of association;
(b) the commission may be paid out of proceeds of the issue or the profit of the company or both;
(c) the rate of commission paid or agreed to be paid shall not exceed, in case of shares, five percent (5%) of the price at which the shares are issued or a rate authorised by the articles, whichever is less, and in case of debentures, shall not exceed two and a half per cent (2.5%) of the price at which the debentures are issued, or as specified in the company’s articles, whichever is less;
(d) the prospectus of the company shall disclose -
   • the name of the underwriters;
   • the rate and amount of the commission payable to the underwriter; and
   • the number of securities which is to be underwritten or subscribed by the underwriter absolutely or conditionally.
(e) there shall not be paid commission to any underwriter on securities which are not offered to the public for subscription;
(f) a copy of the contract for the payment of commission is delivered to the Registrar at the time of delivery of the prospectus for registration.

Thus, the Underwriting commission is limited to 5% of issue price in case of shares and 2.5% in case of debentures. The rates of commission given above are maximum rates. The company is free to negotiate lower rates with underwriters.
LESSON 2: DEBENTURES

REDEMPTION OF DEBENTURES

Introduction
Redemption of debentures refers to the discharge of liability in respect of the debentures issued by a company. According to Section 71 (1) of the Companies Act, 2013, a company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption. According to Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014, the company shall not issue secured debentures, unless it complies with the following conditions, namely:- An issue of secured debentures may be made, provided the date of its redemption shall not exceed ten years from the date of issue. Provided that a company engaged in the setting up of infrastructure projects may issue secured debentures for a period exceeding ten years but not exceeding thirty years.

Therefore, for secured debentures, the date of Redemption of debenture shall not exceed 10 years from the date of issue. A company engaged in the setting up of infrastructure projects may issue secured debentures upto redemption period of thirty years.

Creation of debenture redemption reserve account
Section 71(4) states that when debentures are issued by a company under this section, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures.

Rule 18(7) of Companies (Share Capital and Debentures) Rules, 2014 prescribes the following conditions.

The company shall create a Debenture Redemption Reserve for the purpose of redemption of debentures, in accordance with the conditions given below-

(a) the Debenture Redemption Reserve shall be created out of the profits of the company available for payment of dividend;

(b) the company shall create Debenture Redemption Reserve (DRR) in accordance with following conditions:-

(i) No DRR is required for debentures issued by All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures. For other Financial Institutions (FIs) within the meaning of clause (72) of section 2 of the Companies Act, 2013, DRR will be as applicable to NBFCs registered with RBI.

(ii) For NBFCs registered with the RBI under Section 45-IA of the RBI (Amendment) Act, 1997, ‘the adequacy’ of DRR will be 25% of the value of debentures issued through public issue as per present SEBI (Issue and Listing of Debt Securities) Regulations, 2008, and no DRR is required in the case of privately placed debentures.

(iii) For other companies including manufacturing and infrastructure companies, the adequacy of DRR will be 25% of the value of debentures issued through public issue...
as per present SEBI (Issue and Listing of Debt Securities), Regulations 2008 and also
25% DRR is required in the case of privately placed debentures by listed companies.
For unlisted companies issuing debentures on private placement basis, the DRR will be 25% of the value of debentures.

(c) Every company required to create Debenture Redemption Reserve shall on or before the
30th day of April in each year, invest or deposit, as the case may be, a sum which shall not be less than fifteen percent, of the amount of its debentures maturing during the year ending on the 31st day of March of the next year, in any one or more of the following methods, namely:-

(i) in deposits with any scheduled bank, free from any charge or lien;
(ii) in unencumbered securities of the Central Government or of any State Government;
(iii) in unencumbered securities mentioned in sub-clauses (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882;
(iv) in unencumbered bonds issued by any other company which is notified under sub-clause (f) of section 20 of the Indian Trusts Act, 1882;
(v) the amount invested or deposited as above shall not be used for any purpose other than for redemption of debentures maturing during the year referred above: Provided that the amount remaining invested or deposited, as the case may be, shall not at any time fall below fifteen per cent of the amount of the debentures maturing during the year ending on the 31st day of March of that year;

(d) in case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture issue in accordance with this sub-rule.

(e) the amount credited to the Debenture Redemption Reserve shall not be utilised by the company except for the purpose of redemption of debentures.
Lesson 3: Final Accounts of Companies

Introduction
There is no legal obligation for sole proprietorship and partnership firm to prepare final accounts, but companies have statutory obligations to keep proper books of account and to prepare its final accounts every year in the manner as prescribed in the Companies Act. Chapter IX, sections 128 to 138 of the Companies Act, 2013 deals with the legal provisions relating to the Accounts of Companies. These sections including Schedule II and III were brought into force from 1st April 2014. The relevant rules pertaining to these provisions have also been notified. All these relevant provisions/schedules and rules will be applicable for the financial years commencing on or after 1st April 2014. It is clarified that in respect of financial years that commenced earlier than 1st April 2014, shall be governed by the relevant provisions/schedules and rules of the Companies Act, 1956.

Financial Year
“Financial year”, in relation to any company or body corporate, means the period ending on the 31st day of March every year.
This requirement in case of a company or body corporate, existing on the commencement of 2013 Act, is to be complied within a period of 2 years from commencement of 2013 Act. Where a company has been incorporated on or after the 1st day of January of a year, the period ending on the 31st day of March of the following year, in respect whereof financial statement of the company or body corporate is made up.

Financial statements
1956 Act does not define the term “Financial Statement”. 2013 Act defines the term “financial statement” in relation to a company to include:

(i) a balance sheet as at the end of the financial year;
(ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;
(iii) cash flow statement for the financial year;
(iv) a statement of changes in equity, if applicable; and
(v) any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv): Provided that the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement;

Preparation and Presentation of Financial Statements
Section 129 of the Companies Act 2013 governs the preparation and presentation of financial statements of the company.
(1) The financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under section 133 and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III.

• the items contained in such financial statements shall be in accordance with the accounting standards.
• nothing contained in this sub-section shall apply to any insurance or banking company or any company engaged in the generation or supply of electricity, or to
any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company.

• the financial statements shall not be treated as not disclosing a true and fair view of the state of affairs of the company, merely by reason of the fact that they do not disclose-
  a) in the case of an insurance company, any matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999;
  b) in the case of a banking company, any matters which are not required to be disclosed by the Banking Regulation Act, 1949;
  c) in the case of a company engaged in the generation or supply of electricity, any matters which are not required to be disclosed by the Electricity Act, 2003;
  d) in the case of a company governed by any other law for the time being in force, any matters which are not required to be disclosed by that law.

According to the rules for the purposes of sub-section (1) of section 129, the class of companies as may be notified by the Central Government from time to time, shall mandatorily file their financial statements in Extensible Business Reporting Language (XBRL) format and the Central Government may specify the manner of such filing under such notification for such class of companies. The term ‘Extensible Business Reporting Language’ means a standardized language for communication in electronic form to express, report or file financial information by companies under this rule.

(2) At every annual general meeting of a company, the Board of Directors of the company shall lay before such meeting financial statements for the financial year.

(3) Where a company has one or more subsidiaries, it shall, in addition to financial statements provided under sub-section (2), prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own which shall also be laid before the annual general meeting of the company along with the laying of its financial statement under sub-section (2).

• The company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary or subsidiaries. According to the rules the statement containing the salient feature of the financial statement of a company’s subsidiary or subsidiaries, associate company and joint venture shall be in Form 9.1.

• Further as per the rules the Consolidation of financial statements of the company shall be made in accordance with the Accounting Standards, subject however, to the requirement that if under such Accounting Standards, consolidation is not required for the reason that the company has its immediate parent outside India, then such companies will also be required to prepare Consolidated Financial Statements in the manner and format as specified under Schedule III to the Act.

(4) The provisions of this Act applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, apply to the consolidated financial statements.
(5) Without prejudice to sub-section (1), where the financial statements of a company do not comply with the accounting standards referred to in sub-section (1), the company shall disclose in its financial statements, the deviation from the accounting standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation.

(6) The Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of this section or the rules made thereunder, if it is considered necessary to grant such exemption in the public interest and any such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification.

(7) If a company contravenes the provisions of this section, the managing director, the whole-time director in charge of finance, the Chief Financial Officer or any other person charged by the Board with the duty of complying with the requirements of this section and in the absence of any of the officers mentioned above, all the directors shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

Explanation.—For the purposes of this section, except where the context otherwise requires, any reference to the financial statement shall include any notes annexed to or forming part of such financial statement, giving information required to be given and allowed to be given in the form of such notes under this Act.
INTRODUCTION
According to Section 129 of the Companies Act 2013, all the companies registered under this Act will have to present its financial statements in Schedule III of the Act. The Schedule III of the Companies Act 2013 has been formulated to keep pace with the changes in the economic philosophy leading to privatization and globalization and consequent desired changes/reforms in the corporate financial reporting practices. It deals with the Form of Balance sheet, Statement of Profit and Loss and disclosures to be made therein and it applies uniformly to all the companies registered under the Companies Act, 2013, for the preparation of financial statements of an accounting year. It has several new features like:

- A vertical format for presentation of balance sheet with classification of Balance Sheet items into current and non-current categories.
- A vertical format of Statement of Profit and Loss with classification of expenses based on nature.
- Elimination the concept of “Schedules” and such information is now to be furnished in terms of “Notes to Accounts”.
- It does not contain any specific disclosure for items included in Schedule VI under the head, “Miscellaneous Expenditure”. As per AS-16 borrowing cost and discount or premium relating to borrowing could be amortized over loan period. Further, share issue expenses, discount on shares, discount/ premium on borrowing, etc. are excluded from As-26. These items be amortized over period of benefit i.e., normally 3-5 years. The draft guidance note issued by ICAI suggests that unamortized portion of such expenses be shown under the head “Other Current/Non-current Assets” depending on whether the amount will be amortized in the next 12 months or thereafter.
- Debit Balance of Statement of Profit & Loss A/c will be disclosed under the head, Reserves & Surplus as the negative figure.
- No change in the format of cash flow statement as per revised schedule and therefore its preparation continue to be as per AS-3 on cash flow statement.
- It gives prominence to Accounting Standards (AS) i.e. in case of any conflict between the AS and the Schedule, AS shall prevail.

GENERAL INSTRUCTIONS FOR THE PREPARATION OF BALANCE SHEET AND PROFIT AND LOSS ACCOUNT

- The Schedule III sets out the minimum requirements for disclosure on the face of the Balance Sheet, and the Statement of Profit and Loss (hereinafter referred to as “Financial Statements”) and Notes.
- Line items, sub-line items and sub-totals shall be presented as an addition or substitution on the face of the Financial Statements when such presentation is relevant to an understanding of the company’s financial position or performance or to cater to
industry/sector-specific disclosure requirements or when required for compliance with the amendments to the Companies Act or under the Accounting Standards.

- This means new line items or sub items can be added or substituted on the face of the Financial Statements when such presentation is relevant to an understanding of the company’s financial position or performance or to cater to industry/sector-specific disclosure requirements or when required for compliance with the amendments to the Companies Act or under the Accounting Standards.

- Where compliance with the requirements of the Act including Accounting Standards as applicable to the companies require any change in treatment or disclosure including addition, amendment, substitution or deletion in the head or sub-head or any changes, inter se, in the financial statements or statements forming part thereof, the same shall be made and the requirements of this Schedule shall stand modified accordingly.

- The disclosure requirements specified in this Schedule are in addition to and not in substitution of the disclosure requirements specified in the Accounting Standards prescribed under the Companies Act, 2013. Additional disclosures specified in the Accounting Standards shall be made in the notes to accounts or by way of additional statement unless required to be disclosed on the face of the Financial Statements. Similarly, all other disclosures as required by the Companies Act shall be made in the notes to accounts in addition to the requirements set out in this Schedule.

- Notes to accounts shall contain information in addition to that presented in the Financial Statements and shall provide where required:
  - narrative descriptions or disaggregations of items recognised in those statements; and
  - information about items that do not qualify for recognition in those statements.

- Each item on the face of the Balance Sheet and Statement of Profit and Loss shall be cross-referenced to any related information in the notes to accounts. In preparing the Financial Statements including the notes to accounts, a balance shall be maintained between providing excessive detail that may not assist users of financial statements and not providing important information as a result of too much aggregation.

- Depending upon the turnover of the company, the figures appearing in the Financial Statements may be rounded off as given below:

<table>
<thead>
<tr>
<th>Turnover</th>
<th>Rounding off</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) less than one hundred crore rupees</td>
<td>To the nearest hundreds, thousands, lakhs or millions, or decimals thereof.</td>
</tr>
</tbody>
</table>
Once a unit of measurement is used, it shall be used uniformly in the Financial Statements.

1. Except in the case of the first Financial Statements laid before the Company (after its incorporation) the corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statements including notes shall also be given.
2. For the purpose of this Schedule, the terms used herein shall be as per the applicable Accounting Standards.

PRESENTATION OF BALANCE SHEET

A Balance sheet is a statement of the financial position of an enterprise as at a given date, which exhibits its assets, liabilities, capital, reserves and other account balances at their respective book values.

KEY FEATURES OF BALANCE SHEET

1) The Schedule III permits only Vertical form of presentation.
2) It uses “Equity and Liabilities” and “Assets” as headings.
3) All assets and liabilities classified into current and non-current and presented separately on the face of the Balance Sheet.
4) Number of shares held by each shareholder holding more than 5% shares now needs to be disclosed.
5) Details pertaining to aggregate number and class of shares allotted for consideration other than cash, bonus shares and shares bought back will need to be disclosed only for a period of five years immediately preceding the Balance Sheet date.
6) Any debit balance in the Statement of Profit and Loss will be disclosed under the head “Reserves and surplus.” Earlier, any debit balance in Profit and Loss Account carried forward after deduction from uncommitted reserves was required to be shown as the last item on the asset side of the Balance Sheet.
7) Specific disclosures are prescribed for Share Application money. The application money not exceeding the capital offered for issuance and to the extent not refundable will be shown separately on the face of the Balance Sheet. The amount in excess of subscription or if the requirements of minimum subscription are not met will be shown under “Other current liabilities.”
8) The term “sundry debtors” has been replaced with the term “trade receivables.” ‘Trade receivables’ are defined as dues arising only from goods sold or services rendered in the normal course of business. Hence, amounts due on account of other contractual obligations can no longer be included in the trade receivables.
9) It requires separate disclosure of “trade receivables” outstanding for a period exceeding six months from the date the bill/invoice is due for payment.”
10) “Capital advances” are specifically required to be presented separately under the head “Loans & advances” rather than including elsewhere.

11) Tangible assets under lease are required to be separately specified under each class of asset. In the absence of any further clarification, the term “under lease” should be taken to mean assets given on operating lease in the case of lessor and assets held under finance lease in the case of lessee.

12) Under the Schedule III, other commitments also need to be disclosed.

The format of balance sheet as given in Part I of Schedule III of the Companies Act 2013 is given below.

KEY FEATURES STATEMENT OF PROFIT AND LOSS
1) The name of ‘Profit and Loss Account’ has been changed to “Statement of Profit and Loss”.
2) This format of Statement of Profit and Loss does not mention any appropriation item on its face. Further, ‘below the line’ adjustments to be presented under “Reserves and Surplus” in the Balance Sheet.
3) Any item of income or expense which exceeds one per cent of the revenue from operations or Rs. 100,000 (earlier 1 % of total revenue or Rs. 5,000), whichever is higher, needs to be disclosed separately.
4) In respect of companies other than finance companies, revenue from operations need to be disclosed separately as revenue from (a) sale of products, (b) sale of services and (c) other operating revenues.
5) Net exchange gain/loss on foreign currency borrowings to the extent considered as an adjustment to interest cost needs to be disclosed separately as finance cost.
6) Break-up in terms of quantitative disclosures for significant items of Statement of Profit and Loss, such as raw material consumption, stocks, purchases and sales have been simplified and replaced with the disclosure of “broad heads” only. The broad heads need to be decided based on materiality and presentation of true and fair view of the financial statements.

TRUE AND FAIR VIEW OF FINANCIAL STATEMENTS
According to section 128(1) of the Companies Act 2013, every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company.

Further section 129(1) of the Companies Act 2013, states that the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under section 133 and shall be in the form provided for different class or classes of companies in Schedule III. It also provides also that the financial statements shall not be treated as not disclosing a true and fair view of the state of affairs of the company, merely by reason of the fact that they do not disclose—-
(a) in the case of an insurance company, any matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999;
(b) in the case of a banking company, any matters which are not required to be disclosed by the Banking Regulation Act, 1949;
(c) in the case of a company engaged in the generation or supply of electricity, any matters which are not required to be disclosed by the Electricity Act, 2003;
(d) in the case of a company governed by any other law for the time being in force, any matters which are not required to be disclosed by that law.

Thus, the Companies Act requires that the profit and loss account must exhibit a true and fair view of the profit earned or loss suffered by the company during the period for which the account has been prepared. The term true and fair has not been defined nor had it been the subject of any judicial decision. But in order to show a true and fair view financial statement (Statement of Profit and Loss and Balance Sheet) should not mislead the user about the financial health of the organisation.
TREATMENT OF SPECIAL ITEMS UNDER COMPANIES ACT 2013

Although, the general principles for preparing the final accounts of a company are same as that of partnership firms and sole proprietorship concerns, some special points peculiar to a company are described below.

MANAGERIAL REMUNERATION

The section 197(1) of Companies Act 2013 puts a maximum limit on the total managerial remuneration payable by a public company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year. The remuneration shall not exceed eleven per cent of the net profits of that company for the financial year computed as laid down in section 198 except that the remuneration of the directors shall not be deducted from the gross profits.

The company in general meeting may, with the approval of the Central Government, authorise the payment of remuneration exceeding eleven per cent of the net profits of the company, subject to the provisions of Schedule V.

Further that, except with the approval of the company in general meeting,—

(i) the remuneration payable to any one managing director; or whole-time director or manager shall not exceed five percent of the net profits of the company

(ii) If there is more than one managing director; or whole-time director or manager remuneration shall not exceed ten per cent of the net profits to all such directors and manager taken together;

(iii) the remuneration payable to directors who are neither managing directors nor whole-time directors shall not exceed one per cent of the net profits of the company, if there is a managing or whole-time director or manager;

(iv) the remuneration payable to directors who are neither managing directors nor whole-time directors shall not exceed three per cent of the net profits of the company, if there is no managing or whole-time director or manager;

(2) The percentages aforesaid shall be exclusive of any fees payable to directors for attending meetings of the Board or Committee thereof or for any other purpose whatsoever as may be decided by the Board.

(3) If in any financial year, a company has no profits or its profits are inadequate, the company shall not pay to its directors, including any managing or whole time director or manager, by way of remuneration except in accordance with the provisions of Schedule V and if it is not able to comply with such provisions, with the previous approval of the Central Government. However, the company can pay fee for attending meetings of the Board or Committee thereof or for any other purpose whatsoever as may be decided by the Board.
(4) The remuneration payable to the directors of a company, including any managing or whole-time director or manager, shall be determined, in accordance with and subject to the provisions of this section, either by the articles of the company, or by a resolution or, if the articles, by a special resolution, passed by the company in general meeting and the remuneration payable to a director determined aforesaid shall be inclusive of the remuneration payable to him for the services rendered by him in any other capacity except for -
   a) the services rendered are of a professional nature; and
   b) in the opinion of the Nomination and Remuneration Committee, if the company is covered under sub-section (1) of section 178, or the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession.

(5) A director or manager may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by the other.

(6) An independent director shall not be entitled to any stock option and may receive remuneration by way of fees provided under sub-section (5), reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members. Thus, under the Companies Act 2013, independent directors of a public company can be paid commission other than sitting fees and reimbursement of expenses for attending the meeting provided if the shareholders approval is available for the same.

(7) The net profits for the purposes of this section shall be computed as referred to in section 198.

(8) If any director draws or receives, directly or indirectly, by way of remuneration any such sums in excess of the limit prescribed by this section or without the prior sanction of the Central Government, where it is required, he shall refund such sums to the company and the company cannot waive it and until such sum is refunded, hold it in trust for the company.

(9) The company shall not waive the recovery of any sum refundable to it under sub-section (9) unless permitted by the Central Government.

(10) In cases where Schedule V is applicable on grounds of no profits or inadequate profits, any provision relating to the remuneration of any director which purports to increase or has the effect of increasing the amount thereof, whether the provision be contained in the company’s memorandum or articles, or in an agreement entered into by it, or in any resolution passed by the company in general meeting or its Board, shall not have any effect unless such increase is in accordance with the conditions specified in that
Schedule and if such conditions are not being complied, the approval of the Central Government had been obtained.

(11) Every listed company shall disclose in the Board’s report, the ratio of the remuneration of each director to the median employee’s remuneration and such other details as may be prescribed.

(12) Where any insurance is taken by a company on behalf of its managing director, whole-time director, manager, Chief Executive Officer, Chief Financial Officer or Company Secretary for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company, the premium paid on such insurance shall not be treated as part of the remuneration payable to any such personnel: Provided that if such person is proved to be guilty, the premium paid on such insurance shall be treated as part of the remuneration. Thus any premium paid on the insurance policy to cover the risk for managing director or other directors or Company Secretary shall not form the part of the above limit.

(13) Any director who is in receipt of any commission from the company and who is a managing or whole-time director of the company shall not be disqualified from receiving any remuneration or commission from any holding company or subsidiary company of such company subject to its disclosure by the company in the Board’s report.

(14) If any person contravenes the provisions of this section, he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

PART II of Schedule V

1. Remuneration payable by companies having profits: Subject to the provisions of section 197, a company having profits in a financial year may pay remuneration to a managerial person or persons not exceeding the limits specified in such section.

2. Remuneration payable by companies having no profit or inadequate profit without Central Government approval:
Where in any financial year during the currency of tenure of a managerial person, a company has no profits or its profits are inadequate, it may, without Central Government approval, pay remuneration to the managerial person not exceeding the higher of the limits under (A) and (B) given below:

(A):

<table>
<thead>
<tr>
<th>Where the effective capital is</th>
<th>Limit of yearly remuneration payable shall not exceed (Rupees)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Negative or less than 5 crores</td>
<td>30 lakhs</td>
</tr>
</tbody>
</table>


The above limits shall be doubled if the resolution passed by the shareholders is a special resolution and for a period less than one year, the limits shall be pro-rated.

(B) In the case of a managerial person who was not a security holder holding securities of the company of nominal value of rupees five lakh or more or an employee or a director of the company or not related to any director or promoter at any time during the two years prior to his appointment as a managerial person, — 2.5% of the current relevant profit. The above limits shall be doubled if the resolution passed by the shareholders is a special resolution.

**CALCULATION OF NET PROFITS FOR DETERMINING MANAGERIAL REMUNERATION**

The calculation of net profits of a company in any financial year for the purpose of determining managerial remuneration under section 197 is described in the section 198 of the Companies Act 2013.

According to section 198(2), credit shall be given for the bounties and subsidies received from any Government, or any public authority constituted or authorised in this behalf, by any Government, unless and except in so far as the Central Government otherwise directs.

According to section 198(3), credit shall not be given for the following sums, namely:—

a) profits, by way of premium on shares or debentures of the company, which are issued or sold by the company;

b) profits on sales by the company of forfeited shares;

c) profits of a capital nature including profits from the sale of the undertaking or any of the undertakings of the company or of any part thereof;

d) profits from the sale of any immovable property or fixed assets of a capital nature comprised in the undertaking or any of the undertakings of the company, unless the business of the company consists, whether wholly or partly, of buying and selling any such property or assets:

Provided that where the amount for which any fixed asset is sold exceeds the written-down value thereof, credit shall be given for so much of the excess as is not higher than the difference between the original cost of that fixed asset and its written down value;
e) any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value.

According to section 198(4), the following sums shall be deducted, namely:—

a) all the usual working charges;
b) directors’ remuneration;
c) bonus or commission paid or payable to any member of the company’s staff, or to any engineer, technician or person employed or engaged by the company, whether on a whole-time or on a part-time basis;
d) any tax notified by the Central Government as being in the nature of a tax on excess or abnormal profits;
e) any tax on business profits imposed for special reasons or in special circumstances and notified by the Central Government in this behalf;
f) interest on debentures issued by the company;
g) interest on mortgages executed by the company and on loans and advances secured by a charge on its fixed or floating assets;
h) interest on unsecured loans and advances;
i) expenses on repairs, whether to immovable or to movable property, provided the repairs are not of a capital nature;
j) outgoings inclusive of contributions made under section 181;
k) depreciation to the extent specified in section 123;
l) the excess of expenditure over income, which had arisen in computing the net profits in accordance with this section in any year which begins at or after the commencement of this Act, in so far as such excess has not been deducted in any subsequent year preceding the year in respect of which the net profits have to be ascertained;
m) any compensation or damages to be paid in virtue of any legal liability including a liability arising from a breach of contract;
n) any sum paid by way of insurance against the risk of meeting any liability such as is referred to in clause (m);
o) debts considered bad and written off or adjusted during the year of account.

According to section 198(5), in making the computation aforesaid, the following sums shall not be deducted, namely:—

a) income-tax and super-tax payable by the company under the Income-tax Act, 1961, or any other tax on the income of the company not falling under clauses (d) and (e) of sub-section (4);
b) any compensation, damages or payments made voluntarily, that is to say, otherwise than in virtue of a liability such as is referred to in clause (m) of sub-section (4);
c) loss of a capital nature including loss on sale of the undertaking or any of the undertakings of the company or of any part thereof not including any excess of the written-down value of any asset which is sold, discarded, demolished or destroyed over its sale proceeds or its scrap value;
d) any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value.

DECLARATION OF DIVIDEND
The term “Dividend” refers to that part of the profits of a company which is distributed by the company among its shareholders by way of return on investments made by the shareholders in the shares, of the company. In other words, dividend is nothing but the distribution of divisible or distributable profits of a company among the holders of its shares. Dividend is paid by a company to its shareholders on the basis of number of shares held by them and the rights attaching to the various classes of shares.

Section 123 of the Companies Act 2013 provides following conditions for the payment of dividend.

a) No dividend shall be declared or paid by a company for any financial year except—
   • out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of Schedule II or out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with the provisions of Schedule II and remaining undistributed, or out of both; or
   • out of money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government.

b) The company has to transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company, before the declaration of any dividend in any financial year.

c) No dividend shall be declared or paid by a company from its reserves other than free reserves.

d) In case of inadequacy or absence of profits in any financial year, any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the reserves, such declaration of dividend shall not be made except in accordance with the Companies (Declaration and Payment of Dividend) Rules, 2014. In the event of inadequacy or absence of profits in any year, a company may declare dividend out of free reserves subject to the fulfillment of the following conditions, namely:—
   o The rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the three years immediately preceding that year: Provided that this sub-rule shall not apply to a company, which has not declared any dividend in each of the three preceding financial year.
   o The total amount to be drawn from such accumulated profits shall not exceed one-tenth of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement.
   o The amount so drawn shall first be utilised to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.
o The balance of reserves after such withdrawal shall not fall below fifteen per cent of its paid up share capital as appearing in the latest audited financial statement.
o No company shall declare dividend unless carried over previous losses and depreciation not provided in previous year are set off against profit of the company of the current year the loss or depreciation, whichever is less, in previous years is set off against the profit of the company for the year for which dividend is declared or paid.

e) The Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the profit and loss account and out of profits of the financial year in which such interim dividend is sought to be declared.
f) In case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.
g) The amount of the dividend, including interim dividend, shall be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend.
h) No dividend shall be paid by a company in respect of any share therein except to the registered shareholder of such share or to his order or to his banker and shall not be payable except in cash. Provided that nothing in this sub-section shall be deemed to prohibit the capitalization of profits or reserves of a company for the purpose of issuing fully paid-up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company. Provided further that any dividend payable in cash may be paid by cheque or warrant or in any electronic mode to the shareholder entitled to the payment of the dividend.
i) A company which fails to comply with the provisions of sections 73 and 74 shall not, so long as such failure continues, declare any dividend on its equity shares.

In the TABLE –F of the Companies Act, following provisions are mentioned for Dividends and Reserve.

- The company in general meeting may declare dividends, but no dividend shall exceed the amount recommended by the Board.
- The Board may from time to time pay to the members such interim dividends as appear to it to be justified by the profits of the company.
- The Board may, before recommending any dividend, set aside out of the profits of the company such sums as it thinks fit as a reserve or reserves which shall, at the discretion of the Board, be applicable for any purpose to which the profits of the company may be properly applied, including provision for meeting contingencies or for equalizing dividends; and pending such application, may, at the like discretion, either be employed in the business of the company or be invested in such investments (other than shares of the company) as the Board may, from time to time, thinks fit.
- The Board may also carry forward any profits which it may consider necessary not to divide, without setting them aside as a reserve.
PROVISION FOR DEPRECIATION

Section 123 of the Companies Act 2013 provides that the depreciation shall be provided out of the profits of the company in accordance with the provisions of Schedule II.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. The depreciable amount of an asset is the cost of an asset or other amount substituted for cost, less its residual value. The useful life of an asset is the period over which an asset is expected to be available for use by an entity, or the number of production or similar units expected to be obtained from the asset by the entity. The term depreciation includes amortisation.

Companies whose financial statements comply with the accounting standards prescribed for such class of companies under section 133, shall have the useful life of an asset indicated in Part C of Schedule II. In respect of other companies the useful life of an asset shall not be longer than the useful life and the residual value shall not be higher than that prescribed in Part C.

For intangible assets, the provisions of the Accounting Standards shall apply.

The useful lives of various tangible assets are given in Schedule II of the Companies Act, 2013.
LESSON 5: CONSOLIDATION OF ACCOUNTS

HOLDING AND SUBSIDIARY COMPANY

Meaning and Definition
According to section 2(46) of the Companies Act, 2013, “holding company”, in relation to one or more other companies, means a company of which such companies are subsidiary companies.

According to section 2(87) of the Companies Act, 2013, “subsidiary company” or “subsidiary”, in relation to any other company (that is to say the holding company), means a company in which the holding company—

(i) controls the composition of the Board of Directors; or
(ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed. For the purposes of this clause,—

(a) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;

(b) the composition of a company’s Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;

(c) the expression “company” includes any body corporate;

(d) “layer” in relation to a holding company means its subsidiary or subsidiaries.

The definition of a subsidiary as per the 2013 Act includes associates and joint ventures.

Explanation with Example
Suppose, H is holding company of S because 51% shares are of H in S. S is also of holding Company of R because S have power to appoint the board of directors of R Company and then H is also holding Company of R.

Preparation of Consolidated Financial Statements as Per the Companies Act
The Companies Act 1956 Act does not require preparation of consolidated financial statements (‘CFS’). However, listed entities are required to prepare CFS (as per SEBI regulations). The Companies Act 2013 has made preparation of consolidated accounts mandatory for companies having one or more subsidiaries or associates or joint ventures. According to sub section 3 of the section 129 of the Companies Act, 2013, where a company has one or more subsidiaries or associates or joint ventures, it shall, in addition to its financial statements for the financial year, prepare a consolidated financial statement of the company and of all the subsidiaries or associates or joint ventures in the same form and manner as that of its own which shall also be laid before the annual general meeting of the company along with the laying of its financial statement.

The requirement to prepare CFS is largely consistent with internationally accepted practices. However, internationally, such requirements apply only to listed companies; and unlisted intermediate entities are generally exempted. The existing Indian and international accounting
practices do not require preparation of CFS when the Company has investments only in associates and joint ventures (no subsidiaries).

According to the rules, the company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary or subsidiaries or associates or joint venture in the Form 9.1.

The Consolidation of financial statements of the company shall be made in accordance with the Accounting Standards, subject however, to the requirement that if under such Accounting Standards, consolidation is not required for the reason that the company has its immediate parent outside India, then such companies will also be required to prepare Consolidated Financial Statements in the manner and format as specified under Schedule III to the Act.

**Schedule III of the Companies Act, 2013**
The Schedule III of the Companies Act, 2013, provides certain general instructions for the preparation of consolidated financial statements.

1. Accordingly, where a company is required to prepare Consolidated Financial Statements, i.e., consolidated balance sheet and consolidated statement of profit and loss, the company shall *mutatis mutandis* follow the requirements of Schedule III of the Companies Act, 2013, as applicable to a company in the preparation of balance sheet and statement of profit and loss. In addition, the consolidated financial statements shall disclose the information as per the requirements specified in the applicable Accounting Standards including the following:
   (i) Profit or loss attributable to “minority interest” and to owners of the parent in the statement of profit and loss shall be presented as allocation for the period.
   (ii) “Minority interests” in the balance sheet within equity shall be presented separately from the equity of the owners of the parent.

2. In Consolidated Financial Statements, the following shall be disclosed by way of additional information:

<table>
<thead>
<tr>
<th>Name of the entity in the</th>
<th>Net Assets, <em>i.e.</em>, total assets minus total liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>As % of consolidated net assets</td>
</tr>
<tr>
<td>Parent Subsidiaries Indian</td>
<td>1.</td>
</tr>
</tbody>
</table>
3. All subsidiaries, associates and joint ventures (whether Indian or foreign) will be covered under consolidated financial statements.

4. An entity shall also disclose the list of subsidiaries or associates or joint ventures which have not been consolidated in the consolidated financial statements along with the reasons of not consolidating.
LESSON 9: ACCOUNTING STANDARDS

Introduction
Accounting Standards have assumed great significance in today’s environment, which is constantly evolving and changing. Accounting Standards act as pillars of sound financial reporting system of a country, which is an integral and important part of good corporate governance and provides the shareholders and other stakeholders’ useful information about the entity to make their economic and financial decisions. To strengthen the financial reporting system existing in the country, Accounting Standards are formulated or revised from time to time.

Meaning of Accounting Standards
Accounting Standards (ASs) are written policy documents issued by expert accounting body or by government or any other regulatory body. Accounting Standards covers the aspects of recognition, measurements, treatment, presentation and disclosure of accounting transactions in the financial statements. Thus, accounting standards are guidelines for financial accounting, as how firms prepare and present its business income and expense, assets and liabilities.

According to section 2(2) of the Companies Act 2013 “accounting standards” means the standards of accounting or any addendum thereto for companies or class of companies referred to in section 133.

The Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.

Objective of Accounting Standards
- To harmonise different accounting policies and practices in used in a country.
- To reduce the accounting alternatives in the preparation of financial statements
- To ensure comparability of financial statements of different enterprises
- To call for disclosures beyond that required by the law.

Formation of the Accounting Standards Board
The Institute of Chartered Accountants of India (ICAI) constituted the Accounting Standards Board (ASB) on 21st April, 1977 to harmonise the diverse accounting policies and practices in use in India. ASB of the ICAI has been issuing accounting standards since then. It has issued 32 Accounting Standards and 29 Accounting Standards Interpretations so far. “AS 8- Accounting for Research and Development” has been withdrawn, therefore there are 31 Accounting Standards in effect currently. ASB takes into consideration the applicable laws, customs, usages and business environment prevailing in the country. It also gives due consideration to International Accounting Standards (IASs) and tries to integrate them, to the extent possible, in the light of conditions and practices prevailing in India.
**Composition of the Accounting Standards Board**

The composition of the ASB is fairly broad-based and ensures participation of all interest-groups in the standard-setting process. Apart from the elected members of the Council of the ICAI nominated on the ASB, the following are represented on the ASB:

(i) Nominee of the Central Government representing the Department of Company Affairs on the Council of the ICAI
(ii) Nominee of the Central Government representing the Office of the Comptroller and Auditor General of India on the Council of the ICAI
(iii) Nominee of the Central Government representing the Central Board of Direct Taxes on the Council of the ICAI
(iv) Representative of the Institute of Cost and Works Accountants of India
(v) Representative of the Institute of Company Secretaries of India
(vi) Representatives of Industry Associations (1 from Associated Preface to the Statements of Accounting Standards 3 Chambers of Commerce and Industry (ASSOCHAM), 1 from Confederation of Indian Industry (CII) and 1 from Federation of Indian Chambers of Commerce and Industry (FICCI)
(vii) Representative of Reserve Bank of India
(viii) Representative of Securities and Exchange Board of India
(ix) Representative of Controller General of Accounts
(x) Representative of Central Board of Excise and Customs
(xi) Representatives of Academic Institutions (1 from Universities and 1 from Indian Institutes of Management)
(xii) Representative of Financial Institutions
(xiii) Eminent professionals co-opted by the ICAI (they may be in practice or in industry, government, education, etc.)
(xiv) Chairman of the Research Committee and the Chairman of the Expert Advisory Committee of the ICAI, if they are not otherwise members of the Accounting Standards Board
(xv) Representative(s) of any other body, as considered appropriate by the ICAI

**OBJECTIVES AND FUNCTIONS OF THE ACCOUNTING STANDARDS BOARD**

The following are the objectives of the Accounting Standards Board:

(i) To conceive of and suggest areas in which Accounting Standards need to be developed.
(ii) To formulate Accounting Standards with a view to assisting the Council of the ICAI in evolving and establishing Accounting Standards in India.
(iii) To examine how far the relevant International Accounting Standard/International Financial Reporting Standard can be adapted while formulating the Accounting Standard and to adapt the same.
(iv) To review, at regular intervals, the Accounting Standards from the point of view of acceptance or changed conditions, and, if necessary, revise the same.
(v) To provide, from time to time, interpretations and guidance on Accounting Standards.
(vi) To carry out such other functions relating to Accounting Standards.
The main function of the ASB is to formulate Accounting Standards so that such standards may be established by the ICAI in India. While formulating the Accounting Standards, the ASB will take into consideration the applicable laws, customs, usages and business environment prevailing in India.

The ICAI, being a full-fledged member of the International Federation of Accountants (IFAC), is expected, inter alia, to actively promote the International Accounting Standards Board’s (IASB) pronouncements in the country with a view to facilitate global harmonisation of accounting standards. Accordingly, while formulating the Accounting Standards, the ASB will give due consideration to International Accounting Standards (IASs) issued by the International Accounting Standards Committee (predecessor body to IASB) or International Financial Reporting Standards (IFRSs) issued by the IASB, as the case may be, and try to integrate them, to the extent possible, in the light of the conditions and practices prevailing in India.

The Accounting Standards are issued under the authority of the Council of the ICAI. The ASB has also been entrusted with the responsibility of propagating the Accounting Standards and of persuading the concerned parties to adopt them in the preparation and presentation of financial statements. The ASB will provide interpretations and guidance on issues arising from Accounting Standards. The ASB also reviews the Accounting Standards at periodical intervals and, if necessary, revise the same.

Scope of Accounting Standards

(i) The Accounting Standards which are issued are in conformity with the provisions of the applicable laws, customs, usages and business environment in India. However, if a particular Accounting Standard is found to be not in conformity with law, the provisions of the said law will prevail and the financial statements should be prepared in conformity with such law.

(ii) The Accounting Standards by their very nature cannot and do not override the local regulations which govern the preparation and presentation of financial statements in the country. However, the ICAI will determine the extent of disclosure to be made in financial statements and the auditor’s report thereon. Such disclosure may be by way of appropriate notes explaining the treatment of particular items. Such explanatory notes will be only in the nature of clarification and therefore need not be treated as adverse comments on the related financial statements.

(iii) The Accounting Standards are intended to apply only to items which are material. Any limitations with regard to the applicability of a specific Accounting Standard will be made clear by the ICAI from time to time. The date from which a particular Standard will come into effect, as well as the class of enterprises to which it will apply, will also be specified by the ICAI. However, no standard will have retroactive application, unless otherwise stated.

(iv) In formulation of Accounting Standards, the emphasis would be on laying down accounting principles and not detailed rules for application and implementation thereof.
Procedure for Issuing an Accounting Standard

Broadly, the following procedure is adopted for formulating Accounting Standards:

(i) The ASB determines the broad areas in which Accounting Standards need to be formulated and the priority in regard to the selection thereof.

(ii) In the preparation of Accounting Standards, the ASB will be assisted by Study Groups constituted to consider specific subjects.

(iii) The draft of the proposed standard will normally include the following:

- Objective of the Standard,
- Scope of the Standard,
- Definitions of the terms used in the Standard,
- Recognition and measurement principles, wherever applicable,
- Presentation and disclosure requirements.

(iv) The ASB will consider the preliminary draft prepared by the Study Group and if any revision of the draft is required on the basis of deliberations, the ASB will make the same.

(v) The Exposure Draft of the proposed Standard will be issued for comments by the members of the Institute and the public. The Exposure Draft will specifically be sent to specified bodies (as listed above), stock exchanges, and other interest groups, as appropriate.

(vi) After taking into consideration the comments received, the draft of the proposed Standard will be finalised by the ASB and submitted to the Council of the ICAI.

(vii) The Council of the ICAI will consider the final draft of the proposed Standard, and if found necessary, modify the same in consultation with the ASB. The Accounting Standard on the relevant subject will then be issued by the ICAI.

(viii) For a substantive revision of an Accounting Standard, the procedure followed for formulation of a new Accounting Standard, as detailed above, will be followed.

(ix) Subsequent to issuance of an Accounting Standard, some aspect(s) may require revision which are not substantive in nature. For this purpose, the ICAI may make limited revision to an Accounting Standard. The procedure followed for the limited revision will substantially be the same as that to be followed for formulation of an Accounting Standard, ensuring that sufficient opportunity is given to various interest groups and general public to react to the proposal for limited revision.

Compliance with the Accounting Standards

The Accounting Standards will be mandatory from the respective date(s) mentioned in the Accounting Standard(s). The mandatory status of an Accounting Standard implies that while discharging their attest functions, it will be the duty of the members of the Institute to examine whether the Accounting Standard is complied with in the presentation of financial statements covered by their audit. In the event of any deviation from the Accounting Standard, it will be their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviation.
Ensuring compliance with the Accounting Standards while preparing the financial statements is the responsibility of the management of the enterprise. Statutes governing certain enterprises require of the enterprises that the financial statements should be prepared in compliance with the Accounting Standards, e.g., the Companies Act, 2013 and the Insurance Regulatory and Development Authority (Preparation of Financial Statements and Auditor’s Report of Insurance Companies) Regulations, 2000.

Financial Statements cannot be described as complying with the Accounting Standards unless they comply with all the requirements of each applicable Standard.

**Applicability of Accounting Standards under Companies Act 2013**

Section 129 (1) of the Companies Act, 2013, the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under section 133 and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III: Provided that the items contained in such financial statements shall be in accordance with the accounting standards.

Section 129 (5) of the Companies Act, 2013, without prejudice to sub-section (1), where the financial statements of a company do not comply with the accounting standards referred to in sub-section (1), the company shall disclose in its financial statements, the deviation from the accounting standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation.

According to section 132 (1), the Central Government may, by notification, constitute a National Financial Reporting Authority to provide for matters relating to accounting and auditing standards under this Act.

According to section 132 (2) Notwithstanding anything contained in any other law for the time being in force, the National Financial Reporting Authority shall—

a) 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;

b) monitor and enforce the compliance with accounting standards and auditing standards in such manner as may be prescribed;

c) 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

Section 133-The Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.
Section 134 (5) of the Companies Act, 2013, prescribes that the Directors’ Responsibility Statement shall state that in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures.

Section 143 (2): The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statement which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made there under or under any order made under sub-section (11) and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

Section 143 (3) The auditor’s report shall also state (e) whether, in his opinion, the financial statements comply with the accounting standards;

**International Financial Reporting Standards (IFRS)**

IFRS are now becoming the global financial reporting language. The importance of IFRS has grown significantly in the recent times. However the concept of IFRS is not new. Back in the year 1973, the professional accountancy bodies of developed economies such as USA, London, Germany, Japan, France etc. recognised the need to harmonize the accounting principles and standards followed by different countries and formed International Accounting Standards Committee (IASC). IASC is a not for profit corporation incorporated in USA and operates from London. It took the responsibility of harmonizing accounting practices followed worldwide by issuing International Accounting Standards (IAS). These IAS were adopted by many multinational companies and endorsed by many countries as their own standards. Most of the nations adopted these international standards but modified them according to their situations and environment prevailing in their own country. With the passage of time several country level accounting principles emerged and there were many gaps between these local generally accepted accounting principles and the IAS. So, in the year 2001, international fraternity of accountants decided to revise the whole framework. In 2001, IASC was renamed as International Accounting Standards board (IASB).

The accounting standards issued by IASB are known as International Financial Reporting Standards (IFRS). IFRS is a set of international accounting standards stating how particular types of transactions and other events should be reported in financial statements. IFRS are nothing but principles-based standards, interpretations and the framework adopted by the International Accounting Standards Board (IASB). International Financial Reporting Standards comprise of:

- 9-International Financial Reporting Standards (IFRS)—standards issued after 2001 by IASB.
- 29-International Accounting Standards (IAS)—standards issued before 2001 by IASC which are still valid.
11—interpretations issued by Standing Interpretations Committee (SIC) before 2001. However, in practice IFRS is interchangeably used to denote individual accounting standards issued by IASB as well as International accounting principles collectively. Following are some of the advantages of IFRS:

- Facilitate increased comparability of financial information between companies operating in different countries.
- The financial reporting process would become more transparent.
- The standardization of accounting methodology provides creditors and investors with the ability to analyze businesses around the world using the same financial methods.
- It would also permit international capital to flow more freely.
- It would give investors a better understanding to the financial statements and assess the investment opportunities in other countries.
- It would also benefit the accounting professionals as they will be able to sell their services in the different parts of the world.

All these benefits of IFRS have prompted many countries to pursue convergence of national accounting standards with IFRS. India has also decided to facilitate the convergence of the Indian accounting standards with IFRS and in this direction all existing accounting standards are being revised and converged with corresponding IAS/IFRS. Convergence of entire world towards IFRS would benefit the corporate sector, investors, and regulators and facilitate economic growth as a whole.
LESSON 11: TYPES OF COMPANY AUDIT

AUDIT OF COMPANIES UNDER THE COMPANIES ACT 2013

The Companies Act, 2013 is focused on transparency and disclosure. In the new Act, attempt has been made to cover each aspect of corporate functioning under audit by prescribing various types of audits like internal audit and secretarial audit. The various types of audits prescribed under the Companies Act, 2013 are:

- Statutory Audit
- Internal Audit
- Secretarial Audit
- Cost Audit

STATUTORY AUDIT

Sections 139 to 147 under chapter X of the Companies Act 2013 along with the Companies (Audit and Auditors) Rules, 2014 contain provisions regarding audit and auditors.

- Section 139 contains provision regarding Appointment of auditors.
- Removal, resignation of auditor and giving of special notice is provided in Section 140.
- Section 141 prescribes eligibility, qualifications and disqualifications of auditors.
- Section 142 deals with the provisions of Remuneration of auditors.
- Powers and duties of auditors and auditing standards is provided in Section 143.
- Section 144 provides a list of certain services which auditor is not to render.
- Section 145 deals with signing of Audit Reports.

Appointment of Auditors: The provisions of sub-section 1 of section 139 dealing with appointment of auditors can be briefly stated as under.

- Every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.
- The company shall place the matter relating to such appointment for ratification by members at every annual general meeting.
- Before the appointment of auditor is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor.
- The certificate shall also indicate whether the auditor satisfies the criteria provided in section 141.
- The company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within fifteen days of the meeting in which the auditor is appointed.
- The “appointment” includes reappointment.
Manner and procedure of selection and appointment of auditors: A company shall follow the procedure prescribed under the Rule 3 of the Companies (Audit and Auditors) Rules, 2014 for the selection and appointment of auditors under section 139(1).

- A company that is required to constitute an Audit Committee under section 177, such committee and where such committee is not required, the Board, shall take into consideration the qualifications and experience of the individual or the firm proposed to be considered for appointment as auditor and whether such qualifications and experience are commensurate with the size and requirements of the company.
- While considering the appointment, the Audit Committee or the Board, as the case may be, shall have regard to any order or pending proceeding relating to professional matters of conduct against the proposed auditor before the Institute of Chartered Accountants of India or any competent authority or any Court.
- The Audit Committee or the Board, as the case may be, may call for such other information from the proposed auditor as it may deem fit.
- Where a company is required to constitute the Audit Committee, the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration and in other cases; the Board shall consider and recommend an individual or a firm as auditor to the members in the annual general meeting for appointment.
- If the Board agrees with the recommendation of the Audit Committee, it shall further recommend the appointment of an individual or a firm as auditor to the members in the annual general meeting.
- If the Board disagrees with the recommendation of the Audit Committee, it shall refer back the recommendation to the committee for reconsideration citing reasons for such disagreement.
- If the Audit Committee, after considering the reasons given by the Board, decides not to reconsider its original recommendation, the Board shall record reasons for its disagreement with the committee and send its own recommendation for consideration of the members in the annual general meeting; and if the Board agrees with the recommendations of the Audit Committee, it shall place the matter for consideration by members in the annual general meeting.
- The auditor so appointed shall be subject to ratification in every annual general meeting till the sixth such meeting by way of passing of an ordinary resolution. If the appointment is not ratified by the members of the company, the Board of Directors shall appoint another individual or firm as its auditor or auditors after following the procedure laid down in this behalf under the Act.
- The auditor appointed in the annual general meeting shall hold office from the conclusion of that meeting till the conclusion of the sixth annual general meeting, with the meeting wherein such appointment has been made being counted as the first meeting.

Conditions for appointment and notice to Registrar
The auditor appointed under Rule 3 the Companies (Audit and Auditors) Rules shall submit a certificate that –

• the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act, the Chartered Accountants Act, 1949 and the
rules or regulations made there-under;

- the proposed appointment is as per the term provided under the Act;
- the proposed appointment is within the limits laid down by or under the authority of the Act;
- the list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.
- The notice to Registrar about appointment of auditor under fourth proviso to sub-section (1) of section 139 shall be in Form ADT-1.

**Mandatory Rotation of Auditors:** Under the Section 139(2), the system of rotation of auditors has been introduced for the auditors of listed companies and other class of companies.

The other class of companies (specified companies) shall mean the following classes of companies excluding one person companies and small companies as prescribed under Rule 5 of the Companies (Audit and Auditors) Rules.

a) all unlisted public companies having paid up share capital of rupees ten crore or more;
b) all private limited companies having paid up share capital of rupees twenty crore or more;
c) all companies having paid up share capital of below threshold limit mentioned in (a) and (b) above, but having public borrowings from financial institutions, banks or public deposits of rupees fifty crores or more.

The provisions for rotation of auditors under sub sections 2, 3 and 4 of section 139 are given below:

- If the auditor is an individual, he cannot be auditor of such a company for more than 5 consecutive years.
- If an audit firm/LLP is auditor of the company, it cannot be auditor of such a company for more than two terms of 5 consecutive years (i.e. 10 years)
- If an individual auditor who has completed his one term of 5 years, shall not be eligible for reappointment as auditor in the same company for 5 years from the completion of his term.
- In an audit firm/LLP which has completed its one term of 10 years, shall not be eligible for reappointment as auditor in the same company for 5 years from the completion of its term.
- It may be noted that any firm/LLP which has one or more partners who are also partners in the outgoing audit firm/LLP cannot be appointed as auditors during this 5 year period.
- There is a transition period of three years, from date of enactment of the 2013 Act, to comply with this requirement. All listed companies or specified companies will have to comply with the above provisions relating to rotation of auditors within 3 years from the date of commencement of this Act i.e. within 31st March 2017.
- However there will be no effect on the right of the company to remove an auditor or the right of the auditor to resign from such office of the company because of the provisions mentioned above.
- The members of a company may also provide for the rotation of auditing partner and his team at specified intervals in the audit firm appointed by the company.
• The members of a company may also provide that the audit shall be conducted by more than one auditor.

Manner of rotation of auditors by the companies on expiry of their term: A company shall follow the procedure prescribed under the Rule 6 of the Companies (Audit and Auditors) Rules, 2014 for the rotation of auditors under section 139(2).

• The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent.

• Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee, and in other cases, the Board shall itself consider the matter of rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.

• For the purpose of the rotation of auditors-
  i) in case of an auditor (whether an individual or audit firm), the period for which the individual or the firm has held office as auditor prior to the commencement of the Act shall be taken into account for calculating the period of five consecutive years or ten consecutive years, as the case may be;
  ii) the incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms which includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.

• For the purpose of rotation of auditors,-
  i) a break in the term for a continuous period of five years shall be considered as fulfilling the requirement of rotation;
  ii) if a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.

Appointment of first auditor:

• According to section 139(6), the first auditor of a company, other than a Government company, shall be appointed by the Board of Director within thirty days from the date of registration of the company.

• In the case of failure of the Board to appoint such auditor, it shall inform the members of the company, who shall within ninety days at an extraordinary general meeting appoint such auditor and such auditor shall hold office till the conclusion of the first annual general meeting.

Removal of Auditors

• New Section 140 provides for Removal, Resignation etc. Of Auditors. The procedure given in this section is more or less similar to the existing procedure in section 225 with the following difference.
• (i) Under new section 140 an auditor can be removed from his office before the expiry of his term only after obtaining the previous approval of the Central Government and after passing a Special Resolution by the Members. For this purpose the company will have to comply with the prescribed rules.

• (ii) If an auditor resigns from his office, he is required to file, within 30 days, a statement in the prescribed form with the company and ROC. In the case of a Government company, this form is also required to be filed with C& AG. In this statement the auditor has give reasons and other facts relevant for his resignation. For failure to comply with this requirement, the auditor is punishable with a minimum fine of Rs. 50,000/- which may extend upto Rs. 5 lakh.

• (iii) If the auditor is found to have, directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by the company or any of its officers, the Tribunal can, on its own or on an application by the company, Central Government or any concerned person, direct the company to change the auditors. In the case of such an application by the Central Government for change of Auditors, the Tribunal can, within 15 days, pass an order that the auditor shall not function as such and the Central Government will be able to appoint another auditor. The auditor who is removed by the Tribunal cannot be appointed as an auditor of that company for 5 years. Further, under the new section 447 the auditor who is guilty of fraud will be punishable with imprisonment for a minimum term of six months which may extent to 10 years and shall also be liable to pay a minimum fine of an amount involved in the fraud which may extend to 3 times the said amount. If the fraud involves public interest the minimum period of imprisonment will be 3 years.

• 7.2 Draft Rules 10.5 and 10.6 provide for procedure for removal and resignation of an Auditor.

Qualifications and Disqualifications of Auditors: The section 141 of the Companies Act 2013 deals with the eligibility, qualifications and disqualifications of auditors. This section is similar to the existing section 226 of the Companies Act 1956. Under the 1956 Act, a Chartered Accountant holding a certificate of practice or a firm of Chartered Accountants (only) can be appointed as auditor(s) of a company. The section 141 (1) and (2) of the 2013 Act, in addition, provides:

• A firm of Chartered Accountants or Limited Liability Partnership (LLP) can be appointed as an auditor of a company only if majority partners practising in India are qualified for appointment as an auditor of a company.

• Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.

The Companies Act 2013 has also made addition in the list of disqualifications of auditors. According to the section 141 (3) of the Companies Act 2013, the following persons shall not be eligible for appointment as an auditor of a company:—

a) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;

b) an officer or employee of the company;
c) a person who is a partner, or who is in the employment, of an officer or employee of the company;
d) a person who, or his relative or partner—
   • is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company: Provided that the relative may hold security or interest in the company of face value not exceeding rupees one lakh;
   • is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company in excess of rupees five lakh or
   • has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company in excess of one lakh rupees.
e) a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company. The term “business relationship” shall be construed as any transaction entered into for a commercial purpose, except—
   • commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;
   • commercial transactions which are in the ordinary course of business of the company at arm’s length price – like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.
f) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel;
g) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;
h) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;
i) any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialised services as provided in section 144.

A person who is appointed as an auditor of a company incurs any of the disqualifications mentioned above after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor according to section 141(4) of the Companies Act 2013.

**Remuneration of Auditors:** According to section 142 of the Companies Act 2013, the remuneration of the auditor of a company shall be fixed in its general meeting or in the manner as determined in the general meeting.
   • The remuneration of the first auditor appointed by the board may be fixed by the Board.
• The remuneration shall be in addition to the fee payable to an auditor, include the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him but does not include any remuneration paid to him for any other service rendered by him at the request of the company.

**Powers or Rights of Auditors:** Section 143(1) provides for powers or rights of auditors. Auditor of a company shall have a right of access at all times to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place and shall be entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor and amongst other matters inquire into the following matters, namely:—

(a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;
(b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
(c) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
(d) whether loans and advances made by the company have been shown as deposits;
(e) whether personal expenses have been charged to revenue account;
(f) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading:

The auditor of a company which is a holding company shall also have the right of access to the records of all its subsidiaries in so far as it relates to the consolidation of its financial statements with that of its subsidiaries.

**Duties of Auditors:** Section 143(2), 143(3) and 143(4) provides for the duties of auditors. The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made thereunder or under any order made under sub-section (11) and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year.

The auditor’s report shall also state—

(a) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit
and if not, the details thereof and the effect of such information on the financial statements;

(b) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;

(c) whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company’s auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;

(d) whether the company’s balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;

(e) whether, in his opinion, the financial statements comply with the accounting standards;

(f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;

(g) whether any director is disqualified from being appointed as a director under sub-section (2) of section 164;

(h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

(i) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;

Other matters to be included in auditor’s report: The auditor’s report shall also include their views and comments on the following matters, namely:-

a) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;

b) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;

c) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.

Where any of the matters required to be included in the audit report under this section is answered in the negative or with a qualification, the report shall state the reasons therefor.

Branch Audit: Section 143(8) provides the provisions for branch audit of companies. These provisions are-

- If any company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (the company’s auditor) or by any other person qualified for appointment as an auditor of the company under this Act.

- The branch auditor shall be appointed under section 139.

- If the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company’s auditor or by an accountant or by any other
person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country.

- The branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

Duties and powers of the company’s auditor with reference to the audit of the branch and the branch auditor:

- The duties and powers of the company’s auditor with reference to the audit of the branch and the branch auditor shall be same as the duties and powers of the auditors for the audit of the company under sub section 1 to 4 of section 143.
- The branch auditor shall submit his report to the company’s auditor.
- The provisions of sub-section (12) of section 143 read with rule 12 hereunder regarding reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

Auditing Standards and National Financial Reporting Authority (NFRA): The Companies Act, 2013 provides that every auditor shall comply with the auditing standards. The auditing standards will be prescribed by the Central Government recommended by the Institute of Chartered Accountants of India in consultation with and after examination of the recommendations made by the National Financial Reporting Authority. Until any auditing standards are notified, any standard or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards.

Under the 2013 Act, National Financial Reporting Authority (NFRA) which replaces existing National Advisory Committee on Accounting Standards will make recommendations to the Central Government on laying down auditing and accounting standards applicable to companies. NFRA will monitor and enforce compliance with auditing standards.

Fraud reporting by auditors: Under section 143(12), if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government immediately but not later than sixty days of his knowledge and after following the procedure indicated herein below:

- auditor shall forward his report to the Board or the Audit Committee, as the case may be, immediately after he comes to knowledge of the fraud, seeking their reply or observations within forty-five days;
- on receipt of such reply or observations the auditor shall forward his report and the reply or observations of the Board or the Audit Committee alongwith his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days of receipt of such reply or observations;
- in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty-five days, he shall forward his report to the Central Government alongwith a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he failed to receive
any reply or observations within the stipulated time.

- The report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed post followed by an e-mail in confirmation of the same.
- The report shall be on the letter-head of the auditor containing postal address, e-mail address and contact number and be signed by the auditor with his seal and shall indicate his Membership Number.
- The report shall be in the form of a statement as specified in Form ADT-4.

No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred to in sub-section (12) if it is done in good faith.

The provisions of this section shall mutatis mutandis apply to—
(a) the cost accountant in practice conducting cost audit under section 148; or
(b) the company secretary in practice conducting secretarial audit under section 204.

If any auditor, cost accountant or company secretary in practice do not comply with the provisions of sub-section (12), he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

The term “Fraud” as defined under the 2013 Act is very wide and encompasses every act of omission or commission. “Fraud” in relation to affairs of a company or anybody corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.

Prohibition on the services to be rendered by the auditors:
Section 144 provides that an auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services rendered directly or indirectly to the company or its holding company or subsidiary company, namely:—
(a) accounting and book keeping services;
(b) internal audit;
(c) design and implementation of any financial information system;
(d) actuarial services;
(e) investment advisory services;
(f) investment banking services;
(g) rendering of outsourced financial services;
(h) management services; and
(i) any other kind of services as may be prescribed:
This is a new provision and there was no restriction of this type in the Companies Act 1956. Therefore, an auditor or audit firm who or which has been performing any non-audit services on or before the commencement of this Act shall comply with the provisions of this section before the closure of the first financial year after the date of commencement of the Act i.e within 31st March 2015.

It is also provided in this section that the prohibited non-audit services cannot be rendered by the following associates of the auditor:

i) **If the auditor is an Individual** :- The Individual himself, his relative any person connected or associated with him, or any entity in which the Individual has significant influence or control or whose name or trade mark/brand is used by the Individual.

ii) **If the auditor is a firm or LLP**:- Such firm/LLP either itself or through its partner or through its parent, subsidiary or associate or through any entity in which the firm/LLP or its partner has significant influence or control or whose name, trade mark or brand is used by the firm/LLP or any of its partners.

**Signing of Audit Reports:**
Section 145 of the Companies Act 2013, provides that the person appointed as an auditor of the company shall sign the auditor’s report or sign or certify any other document of the company. It also provides that the qualifications, observations or comments on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor’s report shall be read before the company in general meeting and shall be open to inspection by any member of the company.

**Auditors to attend general meeting:**
Section 146 of the Companies Act 2013, provides that all notices of, and other communications relating to, any general meeting shall be forwarded to the auditor of the company, and the auditor shall, unless otherwise exempted by the company, attend either by himself or through his authorised representative, who shall also be qualified to be an auditor, any general meeting and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.

**Penal Provisions:** Section 147 provides for punishment for contravention of the provisions of sections 139 to 146. These penalty provisions are as under.

- If a company contravenes any of the provisions of sections 139 to 146 it shall be liable to pay minimum fine of Rs. 25,000/- which may extend to Rs. Five lakh. Further, every officer who is in default shall be punishable with imprisonment upto one year and minimum fine of Rs. 10,000/- which may extend to Rs. One lakh or with both.
- If an auditor of a company contravenes any of the provisions of sections 139, 143 144 or 145, the auditor shall be punishable with minimum fine of Rs. 25,000/- which may extend to Rs. Five lakh.
- If it is found that the auditor has contravened the provisions of sections 139, 143 144 or 145, knowingly or wilfully with the intention to deceive the company, its share holders,
creditors or tax authorities, he shall be punishable with imprisonment for a term upto one year and with a minimum fine of Rs. One lakh which may extend upto Rs. 25 lakh.

- If any auditor contravened any of the provisions of sections 139, 143 144 or 145, he shall be liable to-
  b) refund the remuneration received by him to the company and
  c) pay for damages to the company, statutory bodies/authorities or to any other persons for loss arising out of incorrect or misleading statements of particulars made in his audit report.

- The Central Government shall, by notification, specify any statutory body or authority or an officer for ensuring prompt payment of damages to the company or the persons under clause (ii) of sub-section (3) and such body, authority or officer shall after payment of damages to such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification.

- Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil or criminal as provided in this Act or in any other law for the time being in force, for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally.

Other Penalties on Auditor under Companies Act 2013:

(a) Class action suit against the Auditors U/s 245: To protect investor interest, Section 245 of Companies Act 2013 has introduced the concept of class action suits, through which shareholders, depositors can initiate legal action against the company and auditors in the event of fraudulent activity. A class of shareholders or deposit holders can now claim damages or compensation or demand other suitable action against the auditor, including the audit firm, by filing an application with the NCLT.

(b) Prosecution by NFRA (National Financial Reporting Authority) U/s 132: NFRA may investigate either suo moto or on a reference made to it by the Central Government on matters of professional or other misconduct committed by any member or firm of chartered accountants, registered under the Chartered Accountants Act, 1949 chartered accountants. If professional or other misconduct is proved, NFRA has the power to make order for-
  • imposing penalty of (I) not less than one lakh rupees, but which may extend to five times of the fees received, in case of individuals; and (II) not less than ten lakh rupees, but which may extend to ten times of the fee received, in case of firms;
  • debarring the member or the firm from engaging himself or itself from practice as member of the Institute of Chartered Accountant of India referred to in clause (e) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 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.

(c) Punishment for fraud U/s 447: Any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the
amount involved in the fraud, but which may extend to three times the amount involved in the fraud. Provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

(d) **Punishment for false statement U/s 448:** If any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of this Act or the rules made thereunder, any person makes a statement-

- which is false in any material particulars, knowing it to be false; or
- which omits any material fact, knowing it to be material, he shall be liable under section 447.

**INTERNAL AUDIT**

Section 138 under Chapter IX of the Companies Act, 2013 contains provisions regarding internal audit. The provisions regarding internal audit of the company according to section 138 of the Companies Act, 2013 and the Companies (Accounts) Rules, 2014 are discussed below-

**Qualifications for the internal auditor:** The internal auditor shall either be a chartered accountant whether engaged in practice or not or a cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.

**Report of the internal audit:** The report of internal audit shall be submitted to the Board of the company.

**Companies required to appoint internal auditor:** The following class of companies shall be required to appoint an internal auditor or a firm of internal auditors, namely:-

(a) every listed company;
(b) every unlisted public company having-

- paid up share capital of fifty crore rupees or more during the preceding financial year; or
- turnover of two hundred crore rupees or more during the preceding financial year; or
- outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
- outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and
(c) every private company having-

- turnover of two hundred crore rupees or more during the preceding financial year; or
- outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year:

**Other Provisions:**

- All the companies covered under any of the above criteria will have to comply with the requirements of section 138 and this rule within six months of commencement of such section.
The internal auditor may or may not be an employee of the company.

The Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit.

**SECRETARIAL AUDIT**

The Companies Act 2013 has introduced a new requirement of Secretarial Audit for bigger companies, which has been prescribed under Section 204 of the Act. The provisions regarding secretarial audit of the company according to section 204 of the Companies Act, 2013 and the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 are discussed below-

**Companies required conducting secretarial audit:**

1) Every listed company and
2) Company belonging to other class of companies: The other class of companies are
   - every public company having a paid-up share capital of fifty crore rupees or more; or
   - every public company having a turnover of two hundred fifty crore rupees or more.

**Qualifications for the secretarial auditor:** A Secretarial Audit has to be conducted by a Practising Company Secretary in respect of the secretarial and other records of the company.

**Report of the secretarial audit:** A secretarial audit report shall be annexed with the Board’s report of the company. The Board of Directors, in their report made in terms of sub-section (3) of section 134, shall explain in full any qualification or observation or other remarks made by the company secretary in practice in his report under sub-section (1). The format of the Secretarial Audit Report shall be in Form No.MR.3.

**Other Provisions:**

- It shall be the duty of the company to give all assistance and facilities to the company secretary in practice, for auditing the secretarial and related records of the company.
- If a company or any officer of the company or the company secretary in practise, contravenes the provisions of this section, the company, every officer of the company or the company secretary in practice, who is in default, shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees. As per Section 143(14), all provisions regarding rights, duties and obligations of statutory auditors shall also apply to Company Secretary in Practice conducting secretarial audit.

**COST AUDIT**

Section 148 of the Companies Act provides that the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies:
Provided that the Central Government shall, before issuing such order in respect of any class of companies regulated under a special Act, consult the regulatory body constituted or established under such special Act.

- If the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered under sub-section (1) and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order.
- The audit under sub-section (2) shall be conducted by a Cost Accountant in practice who shall be appointed by the Board on such remuneration as may be determined by the members in such manner as may be prescribed: Provided that no person appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records:
  Provided further that the auditor conducting the cost audit shall comply with the cost auditing standards.

“cost auditing standards” mean such standards as are issued by the Institute of Cost and Works Accountants of India, constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government.

- An audit conducted under this section shall be in addition to the audit conducted under section 143.
- The qualifications, disqualifications, rights, duties and obligations applicable to auditors under this Chapter shall, so far as may be applicable, apply to a cost auditor appointed under this section and it shall be the duty of the company to give all assistance and facilities to the cost auditor appointed under this section for auditing the cost records of the company: Provided that the report on the audit of cost records shall be submitted by the cost accountant in practice to the Board of Directors of the company.
- A company shall within thirty days from the date of receipt of a copy of the cost audit report prepared in pursuance of a direction under sub-section (2) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein.
- If, after considering the cost audit report referred to under this section and the information and explanation furnished by the company under sub-section (6), the Central Government is of the opinion that any further information or explanation is necessary, it may call for such further information and explanation and the company shall furnish the same within such time as may be specified by that Government.
- If any default is made in complying with the provisions of this section,—
  a. the company and every officer of the company who is in default shall be punishable in the manner as provided in sub-section (1) of section 147;
  b. the cost auditor of the company who is in default shall be punishable in the manner as provided in sub-sections (2) to (4) of section 147.

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LESSON 2
CAPITAL MARKET INSTRUMENTS

EQUITY SHARES

Equity shares, commonly referred to as ordinary share also represents the form of fractional ownership in which a shareholder, as a fractional owner, undertakes the maximum entrepreneurial risk associated with a business venture. The holder of such shares is the member of the company and has voting rights.

According to explanation (i) to Section 43 of Companies Act, 2013 “equity share capital”, with reference to any company limited by shares, means all share capital which is not preference share capital. Section 43 further provides for equity share capital (i) with voting rights, or (ii) with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed.

Equity capital and further issues of equity capital by a company are generally based on the condition that they will rank pari passu along with the earlier issued share capital in all respects. However, as regards dividend declared by the company such additional capital shall be entitled to dividend ratably for the period commencing from the date of issue to the last day of the accounting year, unless otherwise specified in the articles or in the terms of the issue.

Important characteristics of equity shares are given below:

- Equity shares, have voting rights at all general meetings of the company. These votes have the affect of the controlling the management of the company.

- Equity shares have the right to share the profits of the company in the form of dividend (cash) and bonus shares.

- However even equity shareholders cannot demand declaration of dividend by the company which is left to the discretion of the Board of Directors.

- When the company is wound up, payment towards the equity share capital will be made to the respective shareholders only after payment of the claims of all the creditors and the preference share capital.

- Equity share holders enjoy different rights as members under the Companies Act, 2013 such as:

  (a) The right to vote on every resolution placed before the company – (Section 47)
  (b) The rights to subscribe to shares at the time of further issue of capital by the company (Pre-emptive Right) – (Section 62)
(c) Right to appoint proxy to attend and vote at the meeting on his behalf – (Section 105)
(d) Right to receive copy of annual accounts of the Company – (Section 136)
(e) Right to receive notice of the meeting of members – (Section 101)
(f) Right to inspection of various statutory registers maintained by the company.
(g) Right to requisition extraordinary general meeting of the company – (Section 100)

SHARES WITH DIFFERENTIAL VOTING RIGHTS

Section 43(a)(ii) of the Companies Act, 2013, authorized equity share capital with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed by the Government.

Rule 4 of Companies (Share Capital and Debentures) Rules, 2014 prescribes the following conditions for issue of DVRs:

(a) the articles of association of the company authorizes the issue of shares with differential rights;
(b) the issue of shares is authorized by a special resolution passed at a general meeting of the shareholders.

Where the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot or a poll at a general meeting;

(c) the shares with differential rights shall not exceed twenty-six percent of the total post-issue paid up equity share capital including equity shares with differential rights issued at any point of time;

(d) the company having consistent track record of distributable profit for the last three years;

(e) the company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;

(f) the company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend;

(g) the company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or state level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government;

(h) the company has not been penalized by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934, Securities and Exchange Board of India Act, 1992, Securities Contracts (Regulation) Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act under which such companies being regulated by sectoral regulators.
(i) The explanatory statement to be annexed to the notice of the general meeting should contain the disclosures as mentioned in the rules.

(j) The Board of Directors shall disclose in the Board’s Report for the financial year in which the issue of equity shares with differential rights was completed, the as mentioned in the rules The holders of the equity shares with differential rights shall enjoy all other rights such as bonus shares, rights shares etc., which the holders of equity shares are entitled to, subject to the differential rights with which such shares have been issued.

(k) The company shall not convert its existing share capital with voting rights into equity share capital carrying differential voting rights and vice-versa.

PREFERENCE SHARES

According to explanation (ii) to Section 43 of Companies Act, 2013 “preference share capital”, with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to—

(a) payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and

(b) repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company;

(iii) capital shall be deemed to be preference capital, notwithstanding that it is entitled to either or both of the following rights, namely:—

(a) that in respect of dividends, in addition to the preferential rights to the amounts specified in sub-clause (a) of clause (ii), it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;

(b) that in respect of capital, in addition to the preferential right to the repayment, on a winding up, of the amounts specified in sub-clause (b) of clause (ii), it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

In simple terms, the preference shares are those shares which have rights of preference over equity shares in the case of distribution of dividend and distribution of surplus in the case of winding up. They generally carry a fixed rate of dividend and redeemable after specific period of time. According to Section 55 of the Companies Act, 2013, a Company cannot issues preference shares which are irredeemable.
DEBENTURES

Section 2(30) of the Companies Act, 2013 defines debentures. “Debenture” includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not;

Debenture is a document evidencing a debt or acknowledging it and any document which fulfills either of these conditions is a debenture.

The important features of a debenture are:

1. It is issued by a company as a certificate of indebtedness.
2. It usually indicates the date of redemption and also provides for the repayment of principal and payment of interest at specified date or dates.
3. It usually creates a charge on the undertaking or the assets of the company. In such a case the lenders of money to the company enjoy better protection as secured creditors, i.e. if the company does not pay interest or repay principal amount, the lenders may either directly or through the debenture trustees bring action against the company to realise their dues by sale of the assets/undertaking earmarked as security for the debt.
4. Debentures holders does not have any voting rights.
5. Compulsory payment of interest. The interest on debenture is payable irrespective of whether there are profits made or not.

SWEAT EQUITY SHARES

Section 2 (88) of the Companies Act, 2013 defines “sweat equity shares” means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Company issue shares at a discount or for consideration other than cash to selected employees and directors as per norms approved by the Board of Directors or any committee, like compensation committee, formed for this purpose. This is based on the know how provided or intellectual property rights created and given for value additions made by such directors and employees to the company. It may be noted that the intellectual property right, know how or value additions arise as of now mainly in the case of Information Technology related companies and Pharmaceutical companies. Categories of industries which are eligible to issue sweat equity shares have not been indicated by the Government either in the Act or otherwise.

According to Section 54 of the Companies Act, 2013 a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled:
(a) The issue is authorized by a special resolution passed by the company in the general meeting.

(b) The resolution specifies the number of shares, current market price, consideration if any and the class or classes of directors or employees to whom such equity shares are to be issued.

(c) Not less than one year has elapsed at the date of the issue, since the date on which the company was entitled to commence business.

(d) The sweat equity shares of a company whose equity shares are listed on a recognised stock exchange are issued in accordance with the regulations made by SEBI in this regard and if they are not listed the sweat equity shares are to be issued in accordance with the rule 8 of Companies (Share Capital and Debenture) Rules, 2014.
Angel Fund

Angel fund means a sub-category of Venture Capital Fund under Category I - Alternative Investment Fund that raises funds from angel investors and invests in accordance with the provisions of Chapter III-A of these regulations.

Company with family connection

Company with family connection means:

a. if the angel investor is an individual,
   i. any company which is promoted by such an individual or his relative; or
   ii. any company where the individual or his relative is a director; or
   iii. any company where the person or his relative has control, or shares or voting rights which entitle them to fifteen percent or more of the shares or voting rights in the company.

Explanation I: For the purpose of this clause, "relative" means a person as defined under section 2 (77) of the Companies Act, 2013.

Explanation II: For the purpose of this clause, "control" shall have the same meaning as assigned to it under sub-regulation (1) of regulation 2 of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

b. if the angel investor is a body corporate,
   i. any company which is a subsidiary or a holding company of the investor; or
   ii. any company which is part of the same group or under the same management of the investor; or

Explanation: For the purpose of this clause, "part of the same group" and "under the same management" shall have the same meaning as assigned to it under regulation 23 of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

iii. any company where the body corporate or its directors/partners have control, or shares or voting rights which entitle them to fifteen percent or more of the shares or voting rights in the company.

Investment in Angel Funds

Angel funds shall only raise funds by way of issue of units to angel investors. An angel fund shall have a corpus of at least ten crore rupees. Angel funds shall accept, up to a maximum period of three years, an investment of not less than twenty five lakh rupees from an angel investor.
**Investment by Angel Funds**

Angel funds shall invest only in venture capital undertakings which:

(a) have been incorporated during the preceding three years from the date of such investment;
(b) have a turnover of less than twenty five crore rupees;
(c) are not promoted or sponsored by or related to an industrial group whose group turnover exceeds three hundred crore rupees; and

Explanation I: For the purpose of this clause, "industrial group" shall include a group of body corporates with the same promoter(s)/promoter group, a parent company and its subsidiaries, a group of body corporates in which the same person/group of persons exercise control, and a group of body corporates comprised of associates/subsidiaries/holding companies.

Explanation II: For the purpose of this clause, "group turnover" shall mean combined total revenue of the industrial group.

(d) are not companies with family connection with any of the angel investors who are investing in the company.

(2) Investment by an angel fund in any venture capital undertaking shall not be less than fifty lakh rupees and shall not exceed five crore rupees.

(3) Investment by an angel fund in the venture capital undertaking shall be locked-in for a period of three years.

(4) Angel funds shall not invest in associates.

(5) Angel funds shall not invest more than twenty-five per cent of the total investments under all its schemes in one venture capital undertaking:

Provided that the compliance to this sub-regulation shall be ensured by the Angel Fund at the end of its tenure.

**Investment Conditions for AIFs**

Investments by all categories of Alternative Investment Funds shall be subject to the following conditions:

(a) Alternative Investment Fund may invest in securities of companies incorporated outside India subject to such conditions or guidelines that may be stipulated or issued by the Reserve Bank of India and SEBI from time to time;

(b) Co-investment in an investee company by a Manager or Sponsor shall not be on terms more favourable than those offered to the Alternative Investment Fund;

(c) Category I and II Alternative Investment Funds shall invest not more than twenty five percent of the investible funds in one Investee Company;
(d) Category III Alternative Investment Fund shall invest not more than ten percent of the investible funds in one Investee Company;

(e) Alternative Investment Fund shall not invest in associates except with the approval of seventy five percent of investors by value of their investment in the Alternative Investment Fund;

(f) Un-invested portion of the investible funds may be invested in liquid mutual funds or bank deposits or other liquid assets of higher quality such as Treasury bills, CBLOs, Commercial Papers, Certificates of Deposits, etc. till deployment of funds as per the investment objective;

(g) Alternative Investment Fund may act as Nominated Investor as specified in clause (b) of sub-regulation (1) of regulation 106N of the SEBI (ICDR) Regulations, 2009.

Schemes

The angel fund may launch schemes subject to filing of a scheme memorandum at least ten working days prior to launch of the scheme with SEBI. Such scheme memorandum shall contain all material information about the investments proposed under such scheme. No scheme of the angel fund shall have more than forty-nine angel investors.
Lesson 11
Resource Mobilisation In International Capital Market

INTRODUCTION

Increased globalization and investor appetite for diversification, offer a unique opportunity to companies looking to tap a new investor base, awareness or raise capital. Indian companies are allowed to raise equity capital in the international market through the issue of GDR/ADR/FCCB/FCEB.

REGULATORY FRAMEWORK IN INDIA

Issue of ADR/GDR/FCCBs/FCEBs are regulated by the following regulations in India:

- Foreign Currency Exchangeable Bonds Scheme, 2008
- Notifications/Circulars issued by Ministry of Finance (MoF), GOI.
- Consolidated FDI Policy.
- RBI Regulations/Circulars.
- Companies Act and Rules thereunder.
- Listing Agreement.

EURO ISSUE

Euro issue means modes of raising funds by an Indian company outside India in foreign currency. There are different modes of Euro issue which is as follows:

DEPOSITORY RECEIPTS

Why do Company Issue Depository Receipts

Company issues DRs as a tool to access Global capital markets. Following are the some reason for issuing DRs by a company –

DEPOSITORY RECEIPTS

Depository Receipt (DR) is a negotiable instrument evidencing a fixed number of equity shares of the issuing company being an Indian company, denominated in foreign currency and is being traded in foreign exchanges.
Lesson 11  Resource Mobilisation In International Capital Market

- To raise Capital
- Diversify Shareholder base into extended geographies
- Increase visibility & recognition in international market
- Global Image
- Set Up Employee Stock Option Plans
- Facilitate Merger & Acquisition activity by creating a desirable acquisition currency.

**Purpose of Investors to Invest in Depository Receipts**

- Diversify Portfolio
- Convenience of holding foreign securities in their markets
- Simplification of trading and settlements (DRs trade and settle just like US or EURO securities)
- No restrictions on dealing: DRs are recognized as domestic securities
- Avoid Currency risk.

**ADR & GDR**

An American Depository Receipt (“ADR”) is a dollar denominated form of equity ownership in the form of depository receipts in a non-US company. It represents the foreign shares of the company held on deposit by a custodian bank in the company’s home country and carries the corporate and economic rights of the foreign shares.

GDRs have access usually to Euro market and US market. The US portion of GDRs to be listed on US exchanges to comply with SEC requirements and the European portion are to be complied with EU directive. Listing of GDR may take place in international stock exchanges such as London Stock Exchange, New York Stock Exchange, American Stock Exchange, NASDAQ, Luxemburg Stock Exchange etc.

**Difference between American Depository Receipts (ADR) and Global Depository Receipts (GDR)**

ADR are US $ denominated and traded in US.

GDRs are traded in various places such as New York Stock Exchange, London Stock Exchange, etc.

**PROCESS INVOLVED IN ISSUE OF DEPOSITORY RECEIPTS**

1. Issuing Company (Indian Company)
   - (Issues rupee denominated Equity Shares to Domestic Custodian)
2. Domestic Custodian
   - (Retains rupee denominated shares and instructs overseas Depository to issue Depository Receipts)
3. Overseas Depository
   - (Issue Depository Receipts to foreign investors)
4. Foreign Investor
   - Shares being traded in overseas markets in Depository Receipts form
ISSUE OF ADR/GDR

Depository Receipts (DRs) are negotiable securities issued outside India by a Depository bank, on behalf of an Indian company, which represent the local Rupee denominated equity shares of the company held as deposit by a Custodian bank in India. DRs are traded on Stock Exchanges in the US, Singapore, Luxembourg, London, etc. DRs listed and traded in the US markets are known as American Depository Receipts (ADRs) and those listed and traded elsewhere are known as Global Depository Receipts (GDRs). In the Indian context, DRs are treated as FDI.

(i) Indian companies can raise foreign currency resources abroad through the issue of FCCB/DR (ADRs/ GDRs), in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India thereunder from time to time.

(ii) A company can issue ADRs / GDRs, if it is eligible to issue shares to person resident outside India under the FDI Scheme. However, an Indian listed company, which is not eligible to raise funds from the Indian Capital Market including a company which has been restrained from accessing the securities market by the Securities and Exchange Board of India (SEBI) will not be eligible to issue ADRs/GDRs.

(iii) Unlisted companies shall be allowed to raise capital abroad without the requirement of prior or subsequent listing in India initially for a period of two years w.e.f 11th October, 2013, subject to the following conditions:

(a) Unlisted companies shall list abroad only on exchanges in IOSCO/FATF compliant jurisdictions or those with which SEBI has signed bilateral agreements;

(b) The Companies shall file a copy of the return which they submit to the proposed exchange/regulators also to SEBI for the purpose of Prevention of Money Laundering Act (PMLA). They shall comply with SEBI’s disclosure requirements in addition to that of the primary exchange prior to the listing abroad;

(c) While raising resources abroad, the listing company shall be fully compliant with the FDI policy in force;

(d) The capital raised abroad may be utilized for retiring outstanding overseas debt or for bona fide operations abroad including for acquisitions;

(e) In case the funds raised are not utilized abroad as stipulated at (d) above, such companies shall remit the money back to India within 15 days from the date of raising of funds and such money shall be parked only in AD Category-1 banks recognized by RBI and may be used domestically;

(f) The ADRs/GDRs shall be issued subject to sectoral cap, entry route, minimum capitalization norms, pricing norms, etc. as applicable as per FDI regulations notified from time to time;

(g) The pricing of such ADRs/GDRs to be issued to a person resident outside India shall be determined in accordance with sub-paragraph (viii) below;

(h) The number of underlying equity shares offered for issuance of ADRs/GDRs to be kept with the local custodian shall be determined upfront and ratio of ADRs/GDRs to equity shares shall be decided upfront based on applicable FDI pricing norms of equity shares of unlisted company;

(i) The unlisted Indian company shall comply with the instructions on downstream investment as notified from time to time;

(j) The criteria of eligibility of unlisted company raising funds through ADRs/GDRs shall be as prescribed by Government of India;
There are no end-use restrictions except for a ban on deployment / investment of such funds in real estate or the stock market. There is no monetary limit up to which an Indian company can raise ADRs / GDRs.

The ADR / GDR proceeds can be utilised for first stage acquisition of shares in the disinvestment process of Public Sector Undertakings / Enterprises and also in the mandatory second stage offer to the public in view of their strategic importance.

Voting rights on shares issued under the Scheme shall be as per the provisions of Companies Act, 2013 and in a manner in which restrictions on voting rights imposed on ADR/GDR issues shall be consistent with the Company Law provisions. Voting rights in the case of banking companies will continue to be in terms of the provisions of the Banking Regulation Act, 1949 and the instructions issued by the Reserve Bank from time to time, as applicable to all shareholders exercising voting rights.

Erstwhile OCBs which are not eligible to invest in India and entities prohibited to buy / sell or deal in securities by SEBI will not be eligible to subscribe to ADRs / GDRs issued by Indian companies.

The pricing of ADR / GDR issues including sponsored ADRs / GDRs should be made at a price determined under the provisions of the Scheme of issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India and directions issued by the Reserve Bank, from time to time.

The pricing of sponsored ADRs/GDRs would be determined under the provisions of the Scheme of issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India and directions issued by the Reserve Bank, from time to time.

An Indian company can also sponsor an issue of ADR / GDR. Under this mechanism, the company offers its resident shareholders a choice to submit their shares back to the company so that on the basis of such shares, ADRs / GDRs can be issued abroad. The proceeds of the ADR / GDR issue are remitted back to India and distributed among the resident investors who had offered their Rupee denominated shares for conversion. These proceeds can be kept in Resident Foreign Currency (Domestic) accounts in India by the resident shareholders who have tendered such shares for conversion into ADRs / GDRs.

A limited two-way Fungibility scheme has been put in place by the Government of India for ADRs / GDRs. Under this Scheme, a stock broker in India, registered with SEBI, can purchase shares of an Indian company from the market for conversion into ADRs/GDRs based on instructions received from overseas investors. Re-issuance of ADRs / GDRs would be permitted to the extent of ADRs / GDRs which have been redeemed into underlying shares and sold in the Indian market.

**TERM ONE SHOULD KNOW**

**One way fungibility** – Here investors could cancel their depository receipt and recover the proceeds by selling the underlying shares in the Indian market; DRs once redeemed could not be converted into shares.

**Two way fungibility** – It means that the shares so released can be reconverted by the company into DRs for purchase by the overseas investors. It implies that the re-issuance of DRs would be permitted to the extent of DRs that have been redeemed and underlying shares are sold in domestic market.

**Sponsor** – It is a process of disinvestment by the Indian shareholders of their holding in overseas market.
# PROVISIONS OF COMPANIES ACT, 2013 RELATING TO ISSUE OF GDR


According to Section 2(44) of Companies Act, 2013, “Global Depository Receipt” means any instrument in the form of a depository receipt, by whatever name called, created by a foreign depository outside India and authorised by a company making an issue of such depository receipts;

Section 41 provides that a company may, after passing a special resolution in its general meeting, issue depository receipts in any foreign country in such manner, and subject to such conditions, as may be prescribed.


### Eligibility to issue depository receipts

Rule 3 lays down that a company may issue depository receipts provided it is eligible to do so in terms of the Scheme and relevant provisions of the Foreign Exchange Management Rules and Regulations.

### Conditions for issue of depository receipts

Rule 4 lays down the following conditions to be fulfilled by a company for issue of depository receipts:

1. The Board of Directors of the company intending to issue depository receipts shall pass a resolution authorising the company to do so.

2. The company shall take prior approval of its shareholders by a special resolution to be passed at a general meeting. Provided that a special resolution passed under section 62 for issue of shares underlying the depository receipts, shall be deemed to be a special resolution for the purpose of section 41 as well.

3. The depository receipts shall be issued by an overseas depository bank appointed by the company and the underlying shares shall be kept in the custody of a domestic custodian bank.

4. The company shall ensure that all the applicable provisions of the Scheme and the rules or regulations or guidelines issued by the Reserve Bank of India are complied with before and after the issue of depository receipts.

5. The company shall appoint a merchant banker or a practising chartered accountant or a practising cost accountant or a practising company secretary to oversee all the compliances relating to issue of depository receipts and the compliance report taken from such merchant banker or practising chartered accountant or practising cost accountant or practising company secretary, as the case may be, shall be placed at the meeting of the Board of Directors of the company or of the committee of the Board of directors authorised by the Board in this regard to be held immediately after closure of all formalities of the issue of depository receipts.

Provided that the committee of the Board of directors referred to above shall have at least one independent director in case the company is required to have independent directors.

### Manner and form of depository receipts

Rule 5 deals with the manner and form of issue of depository receipts.

1. The depository receipts can be issued by way of public offering or private placement or in any other manner prevalent abroad and may be listed or traded in an overseas listing or trading platform.

2. The depository receipts may be issued against issue of new shares or may be sponsored against shares held by shareholders of the company in accordance with such conditions as the Central Government or Reserve Bank of India may prescribe or specify from time to time.
(3) The underlying shares shall be allotted in the name of the overseas depository bank and against such shares, the depository receipts shall be issued by the overseas depository bank abroad.

Voting rights

Rule 6 provides the provisions for voting rights of depository receipts holder.

1. A holder of depository receipts may become a member of the company and shall be entitled to vote as such only on conversion of the depository receipts into underlying shares after following the procedure provided in the Scheme and the provisions of this Act.

2. Until the conversion of depository receipts, the overseas depository shall be entitled to vote on behalf of the holders of depository receipts in accordance with the provisions of the agreement entered into between the depository, holders of depository receipts and the company in this regard.

Proceeds of Issue

Rule 7 provides that the proceeds of issues of depository receipts shall either be remitted to a bank account in India or deposited in an Indian bank operating abroad or any foreign bank (which is a Scheduled Bank under the Reserve Bank of India Act, 1934) having operations in India with an agreement that the foreign bank having operations in India shall take responsibility for furnishing all the information which may be required and in the event of a sponsored issue of Depository Receipts, the proceeds of the sale shall be credited to the respective bank account of the shareholders.

Non applicability of certain provisions of the Act

1. The provisions of the Act and any rules issued thereunder insofar as they relate to public issue of shares or debentures shall not apply to issue of depository receipts abroad.

2. The offer document, by whatever name called and if prepared for the issue of depository receipts, shall not be treated as a prospectus or an offer document within the meaning of this Act and all the provisions as applicable to a prospectus or an offer document shall not apply to a depository receipts offer document.

3. Notwithstanding anything contained under section 88 of the Companies Act, 2013, until the redemption of depository receipts, the name of the overseas depository bank shall be entered in the Register of Members of the company.

**PROCEDURE FOR ISSUANCE OF GDR/FCCBS**

**APPROVALS REQUIRED**

The issue of GDRs/FCCBs requires the Approval of a Board of Directors, shareholders, "In principle and Final" approval of Ministry of Finance, Approval of Reserve Bank of India, In-principle consent of Stock Exchange for listing of underlying shares and In-principle consent of Financial institutions.

**Approval of Board of Directors**

A meeting of Board of Directors is required to be held for approving the proposal to raise money from Euro Capital market. A board resolution is to be passed to approve the raising of finance by issue of GDRs/FCCBs. The resolution should indicate therein specific purposes for which funds are required, quantum of the issue, country in which issue is to be launched, time of the issue etc. A director/Sub- Committee of Board of Directors is also to be authorised for seeking Government approval in connection with Euro issue and signing agreements with depository, organising road shows for fixation of price of GDRs. The Board meeting shall also decide and approve the notice of Extraordinary general meeting of shareholders at which special resolution is to be considered.

**Approval of Shareholders**

Proposal for making Euro issue, as proposed by Board of Directors require approval of shareholders. A special
resolution under Section 62 of the Companies Act, 2013 is required to be passed at a duly convened general meeting of the shareholders of the company.

**Approval of Ministry of Finance – “In Principle and Final”**

In case of FCCB issue exceeding US $ 100 million, the company needs to apply to Ministry of Finance for approval.

With respect to ADR/GDR, guidelines issued on the subject dated 19-1-2000 brought ADR/GDR under the automatic route and therefore the requirement of obtaining approval of Ministry of Finance, Department of Economic Affairs has been dispersed with.

Further, private placement of ADR/GDR will also not require prior approval provided the issue is managed by investment banker.

**Procedure for Getting Approval**

Where the approval is required, the following procedure is required to be followed:

An eligible issuing company shall make an application to the Government of India, Ministry of Finance, Deptt. of Economic Affairs, New Delhi, for obtaining ‘In-principle’ approval.

The application should set out in detail the following points:

(a) Proposed project or expansion or diversification programme with details of cost of project and means of financing.

(b) The proposed security viz. Global Depository Receipts (GDRs) or American Depository Receipts (ADRs) against underlying shares or Foreign Currency Convertible Bonds.

(c) In the case of Bonds, particulars of redemption period, rate of interest, time of conversion of bonds to equity shares of the company, price at which such conversion will take place.

(d) In the case of GDRs/ADRs, the price at which the equity shares will be issued.

(e) Justification for the foreign issue.

(f) Other details about the company such as management, financial date, capacity and its utilisation, financial results and management ratios, statutory liabilities, default in respect of interest/installments, of loans from Banks/Financial Institutions. Exports and imports and salient features of the prospective corporate plans and diversification proposals with special reference to foreign exchange requirements.

The Government of India will, if satisfied with the company’s proposals, issue an approval in principle granting permission to the company to mobilise foreign currency resources for a specified amount.

On completion of finalisation of issue structure in consultation with the Lead Manager to the issue, the company should obtain the final approval from the Government.

However, in some cases Foreign Investment Promotion Board (FIPB) clearance is necessary before final approval is given by the Finance Ministry.

Both ‘in principle and final’ approvals are valid for 3 months respectively from the date of issue.

**Approval of Reserve Bank of India**

The issuer company has to obtain approvals from Reserve Bank of India under circumstances specified under the guidelines issued by the concerned authorities from time to time.

RBI vide its press release dated January 20, 2000 granted general permissions to make an international offering of rupee denominated equity shares of the company by way of issue of ADR/GDR.
FCCB covered under the automatic route requires no RBI approval. FCCB issue which exceeds USD 50 million but does not exceed 100 million need to apply to RBI.

**In-principle consent of Stock Exchanges for listing of underlying shares**

The issuing company has to make a request to the domestic stock exchange for in-principle consent for listing of underlying shares which shall be lying in the custody of domestic custodian. These shares, when released by the custodian after cancellation of GDR, are traded on Indian stock exchanges like any other equity shares.

**In-principle consent of Financial Institutions**

Where term loans have been obtained by the company from the financial institutions, the agreement relating to the loan contains a stipulation that the consent of the financial institution has to be obtained. The company must obtain in-principle consent on the broad terms of the proposed issue.

**APPOINTMENT OF INTERMEDIARIES**

The following agencies are normally involved in the Euro issue:

(i) Lead Manager  (ii) Co-Lead/Co-Manager  (iii) Overseas Depository Bank  (iv) Domestic Custodian Banks  (v) Listing Agent  (vi) Legal Advisors  (vii) Printers  (viii) Auditors  (ix) Underwriter

**Lead Manager**

The company has to choose a competent lead manager to structure the issue and arrange for the marketing. Lead managers usually charge a fee as a percent of the issue. The issues related to public or private placement, nature of investment, coupon rate on bonds and conversion price are to be decided in consultation with the lead manager.

**Co-Lead/Co-Manager**

In consultation with the lead manager, the company has to appoint co-lead/co-manager to coordinate with the issuing company/lead manager to make the smooth launching of the Euro issue.

**Overseas Depository Bank**

It is the bank which is authorised by the issuing company to issue Depository Receipts against issue of ordinary shares or Foreign Currency Convertible Bonds of issuing company.

**Domestic Custodian Bank**

This is a banking company which acts as custodian for the ordinary shares or Foreign Currency Convertible Bonds of an Indian company, which are issued by it. The domestic custodian bank functions in co-ordination with the depository bank. When the shares are issued by a company the same are registered in the name of depository and physical possession is handed over to the custodian. The beneficial interest in respect of such shares, however, rests with the investors.

**Listing Agent**

One of the conditions of Euro-issue is that it should be listed at one or more Overseas Stock Exchanges. The appointment of listing agent is necessary to coordinate with issuing company for listing the securities on Overseas Stock Exchanges.

**Legal Advisors**

The issuing company should appoint legal advisors who will guide the company and the lead manager to prepare offer document, depository agreement, indemnity agreement and subscription agreement.
Printers

The issuing company should appoint printers of international repute for printing Offer Circular.

Auditors

The role of issuer company’s auditors is to prepare the auditors report for inclusion in the offer document, provide requisite comfort letters and reconciliation of the issuer company’s accounts between Indian GAAP/UK GAAP/US-GAAP and significant differences between Indian GAAP/UK GAAP/US GAAP.

Underwriters

It is desirable to get the Euro issue underwritten by banks and syndicates. Usually, the underwriters subscribe for a portion of the issue with arrangements for tie-up for the balance with their clients. In addition, they will interact with the influential investors and assist the lead manager to complete the issue successfully.

PRINCIPAL DOCUMENTATION

The following principal documents are involved: (i) Subscription Agreement (ii) Depository Agreement (iii) Custodian Agreement (iv) Agency Agreement (v) Trust Deed

Subscription Agreement

Subscription agreement provides that Lead Managers and other managers agree, severally and not jointly, with the company, subject to the satisfaction of certain conditions, to subscribe for GDRs at the offering price set forth. It may provide that obligations of managers are subject to certain conditions precedent.

Subscription agreement may also provide that for certain period from the date of the issuance of GDR the issuing company will not (a) authorise the issuance of, or otherwise issue or publicly announce any intention to issue; (b) issue offer, accept subscription for, sell, contract to sell or otherwise dispose off, whether within or outside India; or (c) deposit into any depository receipt facility, any securities of the company of the same class as the GDRs or the shares or any securities in the company convertible or exchangeable for securities in the company of the same class as the GDRs or the shares or other instruments representing interests in securities in the company of the same class as the GDRs or the shares.

Subscription agreement also provides, an option to be exercisable within certain period after the date of offer circular, to the lead manager and other managers to purchase upto a certain prescribed number of additional GDRs solely to cover over-allotments, if any.

Depository Agreement

Depository agreement lays down the detailed arrangements entered into by the company with the Depository, the forms and terms of the depository receipts which are represented by the deposited shares. It also sets forth the rights and duties of the depository in respect of the deposited shares and all other securities, cash and other property received subsequently in respect of such deposited shares. Holders of GDRs are not parties to deposit agreement and thus have no contractual rights against or obligations to the company. The depository is under no duty to enforce any of the provisions of the deposit agreement on behalf of any holder or any other person. Holder means the person or persons registered in the books of the depository maintained for such purpose as holders. They are deemed to have notice of, be bound by and hold their rights subject to all of the provisions of the deposit agreement applicable to them. They may be required to file from time to time with depository or its nominee proof of citizenship, residence, exchange control approval, payment of all applicable taxes or other governmental charges, compliance with all applicable laws and regulations and terms of deposit agreement, or legal or beneficial ownership and nature of such interest and such other information as the depository may deem necessary or proper to enable it to perform its obligations under Deposit Agreement.
Lesson 11 ■ Resource Mobilisation In International Capital Market

The company may agree in the deposit agreement to indemnify the depository, the custodian and certain of their respective affiliates against any loss, liability, tax or expense of any kind which may arise out of or in connection with any offer, issuance, sale, resale, transfer, deposit or withdrawal of GDRs, or any offering document.

Copies of deposit agreement are to be kept at the principal office of Depository and the Depository is required to make available for inspection during its normal business hours, the copies of deposit agreement and any notices, reports or communications received from the company.

**Custodian Agreement**

Custodian works in co-ordination with the depository and has to observe all obligations imposed on it including those mentioned in the depository agreement. The custodian is responsible solely to the depository. In the case of the depository and the custodian being same legal entity, references to them separately in the depository agreement or otherwise may be made for convenience and the legal entity will be responsible for discharging both functions directly to the holders and the company.

Whenever the depository in its discretion determines that it is in the best interests of the holders to do so, it may, after prior consultation with the company terminate, the appointment of the custodian and in such an event the depository shall promptly appoint a successor custodian, which shall, upon acceptance of such appointment, become the custodian under the depository agreement. The depository shall notify holders of such change promptly. Any successor custodian so appointed shall agree to observe all the obligations imposed on him.

**Agency Agreement**

In case of FCCBs, the company has to enter into an agency agreement with certain persons known as conversion agents. In terms of this agreement, these agents are required to make the principal and interest payments to the holders of FCCBs from the funds provided by the company. They will also liaise with the company at the time of conversion/redemption option to be exercised by the investor at maturity.

**Trust Deed**

In respect of FCCBs the company enters into a Covenant (known as Trust Deed) with the Trustee for the holders of FCCBs, guaranteeing payment of principal and interest amount on such FCCBs and to comply with the obligations in respect of such FCCBs.

**PRE AND POST LAUNCH – ADDITIONAL KEY ACTIONS**

Apart from obtaining necessary approvals, appointment of various agencies and proper documentation, the following additional key actions are necessary for making the Euro-issue a success.

(i) Constitution of a Board Sub-Committee; (ii) Selection of Syndicate Members; (iii) Constitution of a task force for due diligence; (iv) Listing; (v) Offering Circular; (vi) Research papers; (vii) Pre-marketing; (viii) Timing, pricing and size of the issue; (ix) Roadshows; (x) Book building and pricing of the issue; (xi) Closing of the issue; (xii) Allotment; (xiii) Investor Relation Programme; and (xiv) Quarterly Statement.

**Constitution of a Board Sub-Committee**

To launch a Euro-issue, the issuing company has to take a large number of decisions in time. These decisions normally fall within the power of Board of Directors. It is usually difficult to call Board Meetings frequently and to ensure presence of adequate Board Members. Thus, it is normally advisable to constitute a sub-committee of the Board with full delegation of powers with regard to Euro-issue. The delegation of powers to the Board sub-committee should normally include the following:
EP-CM&SL

- Appointment of agencies
- Authority to make applications for seeking various approvals
- Authority to finalise and execute documents and agreements.
- Decisions about the timing, size and pricing of the issue
- Allotment of shares

**Selection of Syndicate Members**

The success of any Euro-issue depends upon the well planned and coordinated efforts of the syndicate members and the company. The selection of the Syndicate members should be made depending upon the strength and capabilities of each member in different areas of specialisation such as marketing, financial research, distribution etc. The lead manager may be entrusted with the work of selection of syndicate members. The lead manager while selecting the above members, in addition to their strength and capability, should also evaluate their standing, image, reputation, infrastructure, past experience in handling Indian Euro-issue, etc.

**Constitution of a task force for due diligence**

The due diligence is a process in which a team consisting of legal, technical and financial experts of the lead manager meets top executives of the company and visits the sites of the company in order to understand the strengths, weaknesses, problems and opportunities of the company. The team also studies and analyses the balance sheet of the company and its subsidiaries, its financial arrangement with the group, investment pattern and also the future prospects of the company.

It also scrutinise the minutes of the company, various arrangements entered into by the company with regard to marketing, purchase, technology, ancillary units, employment, etc. and analyse the impact of litigations on the profitability of the company.

The purpose of above exercise is to draft the offering circular (prospectus) and work out marketing strategies for the Euro-issue.

**Listing**

One of the conditions of Euro-issues is that the securities are to be listed on one or more Overseas Stock Exchanges. The issuing company has to fulfill all the requirements particularly disclosure and documentation as prescribed by the Overseas Stock Exchanges. The company shall take the help of the listing agent in getting its Euro-issue instruments listed on the Overseas Stock Exchanges.

The issuing company shall prepare the requisite documents as prescribed by the Overseas Stock exchange authorities and submit the same along with application to it after scrutinizing the application and obtain the formal listing approval shall be issued by the Overseas Stock Exchange.

The underlying shares against GDRs are to be listed on one or more Indian Stock Exchange(s) on which the company’s existing shares are already listed. For this purpose, the company has to apply to the stock exchange authorities to get the shares represented by GDRs listed on the Indian Stock Exchanges. Trading of such shares on Indian Stock Exchange(s) will not commence until the period specified in the guidelines after the date of issue of the GDRs.

**Offering Circular**

Offering Circular is a mirror through which the prospective investors can access vital information regarding the company in order to form their investment strategies.

It is to be prepared very carefully giving true and complete information regarding the financial strength of the company, its past performance, past and envisaged research and business promotion activities, track record of promoters and the company, ability to trade the securities on Euro capital market.
The Offering Circular should be very comprehensive to take care of overall interests of the prospective investor. The Offering Circular for Euro-issue offering should typically cover the following contents:

(i) Background of the company and its promoters including date of incorporation and objects, past performance, production, sales and distribution network, future plans, etc.

(ii) Capital structure of the company-existing, proposed and consolidated.

(iii) Deployment of issue proceeds.

(iv) Financial data indicating track record of consistent profitability of the company.

(v) Group investments and their performance including subsidiaries, joint venture in India and abroad.

(vi) Investment considerations.

(vii) Description of shares.

(viii) Terms and conditions of global depository receipt and any other instrument issued along with it.

(ix) Economic and regulatory policies of the Government of India.

(x) Details of Indian securities market indicating stock exchange, listing requirements, foreign investments in Indian securities.

(xi) Market price of securities.

(xii) Dividend and capitalisation.

(xiii) Securities regulations and exchange control.

(xiv) Tax aspects indicating analysis of tax consequences under Indian law of acquisition, membership and sale of shares, treatment of capital gains tax, etc.

(xv) Status of approvals required to be obtained from Government of India.

(xvi) Summary of significant differences in Indian GAAP, UK GAAP and US GAAP and expert's opinion.

(xvii) Report of statutory auditor.

(xviii) Subscription and sale.

(xix) Transfer restrictions in respect of instruments.

(xx) Legal matters etc.

(xxi) Other general information not forming part of any of the above.

A copy of the Offering Circular is required to be sent to the Registrar of Companies, the SEBI and the Indian Stock Exchanges for record purposes.

Research Papers

Research analysts team of lead manager/co-lead manager prepares research papers on the company before the issue. These papers are very important marketing tools as the international investors normally depend a lot on the information provided by the research analysts for making investment decisions.

Pre-marketing

Pre-marketing exercise is a tool through which the syndicate members evaluate the prospects of the issue. This is normally done closer to the issue. The research analysts along with the sales force of the syndicate members meet the prospective investors during pre-marketing roadshows. This enables the syndicate members to understand the market and the probable response from the prospective investors. The pre-marketing exercise helps in assessing the depth of investors’ interest in the proposed issue, their view about the valuation of the
share and the geographical locations of the investors who are interested in the issue. The response received during pre-marketing provides vital information for taking important decisions relating to timing, pricing and size of the issue. This would also help the syndicate members in evolving strategies for marketing the issue.

**Timing, pricing and size of the Issue**

After pre-marketing exercise, the important decisions of timing, pricing and size of the issue are taken. The proper time of launching the issue is when the fundamentals of the company and the industry are strong and the market price of the shares are performing well at Indian Stock Exchanges. The timing should also not clash with some other major issues of the Indian as well as other country companies. The decision regarding the size of issue is inversely linked with the pricing i.e. larger the size, the comparatively lower the price or vice-versa.

**Roadshows**

Roadshows represent meetings of issuers, analysts and potential investors. Details about the company are presented in the roadshows and such details usually include the following information about the company making the issue:

- History
- Organisational structure
- Principal objects
- Business lines
- Position of the company in Indian and international market
- Past performance of the company
- Future plans of the company
- Competition - domestic as well as foreign
- Financial results and operating performance
- Valuation of shares
- Review of Indian stock market and economic situations.

Thus at road shows, series of information presentations are organised in selected cities around the world with analysts and potential institutional investors. It is, in fact, a conference by the issuer with the prospective investors.

Road show is arranged by the lead manager by sending invitation to all prospective investors.

**Book building and pricing of the Issue**

During road shows, the investors give indication of their willingness to buy a particular quantity at particular terms. Their willingness is booked as orders by the marketing force of lead manager and co-lead manager. This process is known as book building.

Price is a very critical element in the market mix of any product or service. This is more so in case of financial assets like stocks and bonds and specially in case of Euro issues. The market price abroad has a strong correlation to the near future earnings potential, fundamentals governing industry and the basic economic state of the country. Several other factors like prevalent practices, investor sentiment, behaviour towards issues of a particular country, domestic market process etc., are also considered in determination of issue price. Other factors such as the credit rating of the country, interest rate and the availability of an exit route are important.
**Closing of the Issue and Allotment**

Closing is essentially an activity confirming completion of all legal documentation and formalities based on which the company issues the share certificate to the depository and deposits the same with the domestic custodian. Once the issue is closed and all legal formalities are over, the allotment is finalised. Thereafter, the company issues shares in favour of the Overseas Depository Bank and deposits the same with the domestic custodian for custody. The particulars of the Overseas Depository Bank are required to be entered into the Register of Members of the company.

**Investor Relation Programme**

The international investors expect that the issuing company maintains contact with them after the issue. These investors always like to be informed by the company about the latest developments, the performance of the company, the factors affecting performance and the company's plans. It is, therefore, essential for the GDR issuing company to set up an investor relation programme. Good investor relation ensures goodwill towards the company and it would help the company in future fund raising efforts.

**FOREIGN CURRENCY EXCHANGEABLE BONDS**

Issue of Foreign Currency Exchangeable Bonds (FCEB) are regulated by Foreign Currency Exchangeable Bond Scheme 2008 issued by Ministry of Finance, Department of Economic Affairs.

<table>
<thead>
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<th>What is FCEB?</th>
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<td>(i) a bond expressed in foreign currency,</td>
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<td>(ii) the principal and the interest in respect of which is payable in foreign currency</td>
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<td>(iii) issued by an issuing company, being an Indian company</td>
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<tr>
<td>(iv) subscribed by a person resident outside India</td>
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<tr>
<td>(v) Exchangeable into equity shares of another company, being offered company which is an Indian company.</td>
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<tr>
<td>(vi) Either wholly or partly or on the basis of any equity related warrants attached to debt instruments.</td>
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</table>

It may be noted that issuing company to be the part of promoter group of offered company and the offered company is to be listed and is to be eligible to receive foreign investment.

The launch of the Foreign Currency Exchangeable Bonds (FCEB) scheme affords a unique opportunity for Indian promoters to unlock value in group companies. FCEBs are another arrow in the quiver of Indian promoters to raise money overseas to fund their new projects and acquisitions, both Indian and global, by leveraging a part their shareholding in listed group entities.

An FCEB involves three parties –

(i) The issuer company (issuer),
(ii) The offered company (OC) and
(iii) Investor.

Under this option, an issuer company may issue FCEBs in foreign currency, and these FCEBs are convertible into shares of another company (offered company) that forms part of the same promoter group as the issuer company. For Example, company ABC Ltd. issues FCEBs, then the FCEBs will be convertible into shares of company XYZ Ltd. that are held by company ABC Ltd. and where companies ABC Ltd. and XYZ Ltd. form part of the same promoter group. Unlike FCCBs that convert into shares of issuer itself, FCEBs are exchangeable into shares of OC. Also, relatively, FCEB has an inherent advantage that it does not result in dilution of shareholding at the OC level.
DIFFERENCE BETWEEN FCCB AND FCEB

There is a fundamental difference between an FCCB and an FCEB whereby in the case of an FCCB offering, the bonds convert into shares of the company that issued the bonds, while in the case of an FCEB offering, the bonds are convertible into shares not of the issuer company, but that of another company forming part of its group.

ISSUE OF FOREIGN CURRENCY EXCHANGEABLE BONDS (FCEB) SCHEME, 2008

In Financial Year 2007-08, the Indian Government notified the Foreign Currency Exchangeable Bonds Scheme, 2008 for the issue of FCEBs. The provisions of the scheme is as under:

**Eligible Issuer:** The Issuing Company shall be part of the promoter group of the Offered Company and shall hold the equity share/s being offered at the time of issuance of FCEB.

**Offered Company:** The Offered Company shall be a listed company, which is engaged in a sector eligible to receive Foreign Direct Investment and eligible to issue or avail of Foreign Currency Convertible Bond (FCCB) or External Commercial Borrowings (ECB).

**Entities not eligible to issue FCEB:** An Indian company, which is not eligible to raise funds from the Indian securities market, including a company which has been restrained from accessing the securities market by the SEBI shall not be eligible to issue FCEB.

**Eligible subscriber:** Entities complying with the Foreign Direct Investment policy and adhering to the sectoral caps at the time of issue of FCEB can subscribe to FCEB. Prior approval of the Foreign Investment Promotion Board, wherever required under the Foreign Direct Investment policy, should be obtained.

**Entities not eligible to subscribe to FCEB:** Entities prohibited to buy, sell or deal in securities by the SEBI will not be eligible to subscribe to FCEB.

**End-use of FCEB proceeds**

**Issuing Company:**

(i) The proceeds of FCEB may be invested by the issuing company overseas by way of direct investment including in Joint Ventures or Wholly Owned Subsidiaries abroad, subject to the existing guidelines on overseas investment in Joint Ventures / Wholly Owned Subsidiaries.
(ii) The proceeds of FCEB may be invested by the issuing company in the promoter group companies. 

Promoter Group Companies: Promoter group companies receiving investments out of the FCEB proceeds may utilize the amount in accordance with end-uses prescribed under the ECB policy.

**End-uses not permitted**

The promoter group company receiving such investments will not be permitted to utilise the proceeds for investments in the capital market or in real estate in India.

**All-in-cost:** The rate of interest payable on FCEB and the issue expenses incurred in foreign currency shall be within the all-in-cost ceiling as specified by Reserve Bank under the ECB policy.

**Pricing of FCEB:** At the time of issuance of FCEB the exchange price of the offered listed equity shares shall not be less than the higher of the following two:

(i) The average of the weekly high and low of the closing prices of the shares of the offered company quoted on the stock exchange during the six months preceding the relevant date; and (ii) The average of the weekly high and low of the closing prices of the shares of the offered company quoted on a stock exchange during the two week preceding the relevant date.

**Average Maturity:** Minimum maturity of FCEB shall be five years. The exchange option can be exercised at any time before redemption. While exercising the exchange option, the holder of the FCEB shall take delivery of the offered shares. Cash (Net) settlement of FCEB shall not be permissible.

**Parking of FCEB proceeds abroad:** The proceeds of FCEB may be retained and / or deployed overseas by the issuing / promoter group companies in accordance with the policy for the ECB or repatriated to India for credit to the borrowers’ Rupee accounts with AD Category I banks in India pending utilization for permissible end-uses. It shall be the responsibility of the issuing company to ensure that the proceeds of FCEB are used by the promoter group company only for the permitted end-uses prescribed under the ECB policy. The issuing company should also submit audit trail of the end-use of the proceeds by the issuing company / promoter group companies to the Reserve Bank duly certified by the designated AD bank.

**Operational Procedure:** Issuance of FCEB shall require prior approval of the Reserve Bank under the Approval Route for raising ECB. The Reporting arrangement for FCEB shall be as per the extant ECB policy.

**FOREIGN CURRENCY CONVERTIBLE BONDS**

The FCCBs are unsecured, carry a fixed rate of interest and an option for conversion into a fixed number of equity shares of the issuer company. Interest and redemption price (if conversion option is not exercised) is payable in dollars. FCCBs shall be denominated in any freely convertible Foreign Currency. However, it must be kept in mind that FCCB issue proceeds need to conform to ECB end-use requirements.

Foreign investors also prefer FCCBs because of the Dollar denominated servicing, the conversion option and, the arbitrage opportunities presented by conversion of the FCCBs into equity at a discount on prevailing Indian market price.

In addition, 25% of the FCCB proceeds can be used for general corporate restructuring.

The major drawbacks of FCCBs are that the issuing company cannot plan its capital structure as it is not assured of conversion of FCCBs. Moreover, the projections for cash outflow at the time of maturity cannot be made.

**Benefits to the Issuer Company**

- Being Hybrid instrument, the coupon rate on FCCB is particularly lower than pure debt instrument there by reducing the debt financing cost.
• FCCBs are book value accretive on conversion. It saves risks of immediate equity dilution as in the case of public shares. Unlike debt, FCCB does not require any rating nor any covenant like securities, cover etc.

• It can be raised within a month while pure debt takes a longer period to raise. Because the coupon is low and usually payable at the time of redeeming the instrument, the cost of withholding tax is also lower for FCCBs compared with other ECB instruments.

Benefits to Investors

• It has advantage of both equity and debt.

• It gives the investor much of the upside of investment in equity, and the debt portion protects the downside.

• Assured return on bond in the form of fixed coupon rate payments.

• Ability to take advantage of price appreciation in the stock by means of warrants attached to the bonds, which are activated when price of a stock reaches a certain point.

• Significant Yield to maturity (YTM) is guaranteed at maturity.

• Lower tax liability as compared to pure debt instruments due to lower coupon rate.

FCCB AND ORDINARY SHARES (THROUGH DEPOSITORY RECEIPT MECHANISM) SCHEME, 1993

DEFINITIONS

Domestic Custodian Bank
It means a banking company which acts as a custodian for the ordinary shares or Foreign Currency Convertible Bonds of an Indian Company which are issued by it against Global Depository Receipts or certificates.

Foreign Currency Convertible Bonds
It means bonds issued in accordance with this scheme and subscribed by a non-resident in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part, on the basis of any equity related warrants attached to debt instruments.

Global Depository Receipts
It mean any instrument in the form of a Depository receipt or certificate (by whatever name it is called ) created by the Overseas Depository Bank outside India and issued to non-resident investors against the issue of ordinary shares or Foreign Currency Convertible Bonds of issuing company.

Issuing Company
It means an Indian Company permitted to issue Foreign Currency Convertible Bonds or ordinary shares of that company against Global Depository Receipts.

Overseas Depository Bank
It means a bank authorised by the issuing company to issue Global Depository Receipts against issue of Foreign Currency Convertible Bonds or ordinary shares of the issuing company.

FCCBs are governed by the 'Issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993' as amended from time to time and Notification FEMA No.120/ RB-2004 dated July 7, 2004. The issuance of FCCBs was brought under the ECB guidelines in August 2005 In addition to the requirements of (i) having the maturity of the FCCB not less than 5 years, (ii) the call & put option, if any, shall not be exercisable prior to 5 years, (iii) issuance of FCCBs only without any warrants attached, (iv) the issue related expenses not exceeding 4% of issue size and in case of private placement, shall not exceed
2% of the issue size, etc. as required in terms of Notification FEMA No. 120/RB-2004 dated July 7, 2004, FCCBs are also subject to all the regulations which are applicable to ECBs.

**Redemption of FCCBs**

Keeping in view the need to provide a window to facilitate refinancing of FCCBs by the Indian companies which may be facing difficulty in meeting the redemption obligations, Designated AD Category - I banks have been permitted to allow Indian companies to refinance the outstanding FCCBs, under the automatic route, subject to compliance with the terms and conditions set out hereunder:

(i) Fresh ECBs/ FCCBs shall be raised with the stipulated average maturity period and applicable all-in-cost being as per the extant ECB guidelines;

(ii) The amount of fresh ECB/FCCB shall not exceed the outstanding redemption value at maturity of the outstanding FCCBs;

(iii) The fresh ECB/FCCB shall not be raised six months prior to the maturity date of the outstanding FCCBs;

(iv) The purpose of ECB/FCCB shall be clearly mentioned as ‘Redemption of outstanding FCCBs’ in Form 83 at the time of obtaining Loan Registration Number from the Reserve Bank;

(v) The designated AD - Category I bank should monitor the end-use of funds;

(vi) ECB / FCCB beyond USD 500 million for the purpose of redemption of the existing FCCB will be considered under the approval route; and

(vii) ECB / FCCB availed of for the purpose of refinancing the existing outstanding FCCB will be reckoned as part of the limit of USD 750 million available under the automatic route as per the extant norms.

Restructuring of FCCBs involving change in the existing conversion price is not permissible. Proposals for restructuring of FCCBs not involving change in conversion price will, however, be considered under the approval route depending on the merits of the proposal.

**EXTERNAL COMMERCIAL BORROWING**

Indian Companies are allowed to access funds from abroad through ECB, FCEBs, Preference shares and FCCBs.

External Commercial Borrowings (ECB) refer to commercial loans in the form of bank loans, buyers’ credit, suppliers’ credit, securitized instruments (e.g. floating rate notes and fixed rate bonds, non-convertible, optionally convertible or partially convertible preference shares) availed of from non-resident lenders with a minimum average maturity of 3 years. ECB can be accessed under two routes, viz., (i) Automatic Route and (ii) Approval Route.

ECB for investment in real sector-industrial sector, infrastructure sector in India, and specified service sectors are under Automatic Route, i.e. do not require Reserve Bank / Government of India approval. In case of doubt as regards eligibility to access the Automatic Route, applicants may take recourse to the Approval Route.

Infrastructure sector is defined as (i) power, (ii) telecommunication, (iii) railways, (iv) roads including bridges, (v) sea port and airport, (vi) industrial parks, (vii) urban infrastructure (water supply, sanitation and sewage projects), (viii) mining, exploration and refining and (ix) cold storage or cold room facility, including for farm level pre-cooling, for preservation or storage of agricultural and allied produce, marine products and meat.
AUTOMATIC ROUTE

The following types of proposals for ECBs are covered under the Automatic Route.

i) Eligible Borrowers

(a) Corporates, including those in the hotel, hospital, software sectors (registered under the Companies Act, 2013), Non-Banking Finance Companies (NBFCs) - Infrastructure Finance Companies (IFCs), NBFCs - Asset Finance companies (AFCs), Small Industries Development Bank of India (SIDBI) except financial intermediaries, such as banks, financial institutions (FIs), Housing Finance Companies (HFCs) and Non-Banking Financial Companies (NBFCs), other than those specifically allowed by Reserve Bank, are eligible to raise ECB. Individuals, Trusts (other than those engaged in Micro-finance activities) and Non-Profit making organizations are not eligible to raise ECB.

(b) Units in Special Economic Zones (SEZ) are allowed to raise ECB for their own requirement. However, they cannot transfer or on-lend ECB funds to sister concerns or any unit in the Domestic Tariff Area (DTA).

(c) NBFCs-IFCs are permitted to avail of ECBs for on-lending to the infrastructure sector as defined under the ECB policy.

(d) NBFCs-AFCs are permitted to avail of ECBs for financing the import of infrastructure equipment for leasing to infrastructure projects.

(e) Non-Government Organizations (NGOs) engaged in micro finance activities are eligible to avail of ECB.

(f) Micro Finance Institutions (MFIs) engaged in micro finance activities are eligible to avail of ECBs. MFIs registered under the Societies Registration Act, 1860, MFIs registered under Indian Trust Act, 1882, MFIs registered either under the conventional state-level cooperative acts, the national level multi-state cooperative legislation or under the new state-level mutually aided cooperative acts (MACS Act) and not being a co-operative bank, Non-Banking Financial Companies (NBFCs) categorized as ‘Non Banking Financial Company-Micro Finance Institutions’ (NBFC-MFIs) and complying with the norms prescribed as per Circular DNBS.CC.PD.No. 250/03.10.01/2011-12 dated December 02, 2011 and Companies registered under Section 8 of the Companies Act, 2013 and are involved in micro finance activities.

(g) NGOs engaged in micro finance and MFIs registered as societies, trusts and co-operatives and engaged in micro finance (i) should have a satisfactory borrowing relationship for at least 3 years with a scheduled commercial bank authorized to deal in foreign exchange in India and (ii) would require a certificate of due diligence on ‘fit and proper’ status of the Board/ Committee of management of the borrowing entity from the designated AD bank.

(h) Small Industries Development Bank of India (SIDBI) can avail of ECB for on-lending to MSME sector, as defined under the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006.

(i) Corporates in the services sector viz. hotels, hospitals and software sector.

(j) Companies in miscellaneous services sector (only from direct / indirect equity holders and group companies). Companies in miscellaneous services mean companies engaged in training activities (but not educational institutes), research and development activities and companies supporting infrastructure sector. Companies doing trading business, companies providing logistics services, financial services and consultancy services are, however, not covered under the facility.

(k) Holding Companies / Core Investment Companies (CICs) coming under the regulatory framework
of the Reserve Bank are permitted to raise ECB for project use in Special Purpose Vehicles (SPVs) provided the business activity of the SPV is in the infrastructure sector where “infrastructure” is defined as per the extant ECB guidelines. The infrastructure project is required to be implemented by the SPV established exclusively for implementing the project and is subject to conditions In case of Holding Companies that come under the Core Investment Company (CIC) regulatory framework of the Reserve Bank, the ECB availed should be within the ceiling of leverage stipulated for CICs and in case of CICs with asset size below Rs. 100 crore, the ECB availed of should be on fully hedged basis.

ii) Recognised Lenders

(1) Borrowers can raise ECB from internationally recognized sources, such as (a) international banks, (b) international capital markets, (c) multilateral financial institutions (such as IFC, ADB, CDC, etc.) / regional financial institutions and Government owned development financial institutions, (d) export credit agencies, (e) suppliers of equipments, (f) foreign collaborators and (g) foreign equity holders [other than erstwhile Overseas Corporate Bodies (OCBs).

(2) NGOs engaged in micro finance and MFIs registered as societies, trusts and co-operatives can avail of ECBs from (a) international banks, (b) multilateral financial institutions, (c) export credit agencies (d) overseas organisations and (e) individuals.

(3) NBFC-MFIs will be permitted to avail of ECBs from multilateral institutions, such as IFC, ADB etc./ regional financial institutions/international banks /foreign equity holders and overseas organisations.

(4) Companies registered under Section 8 of the Companies Act, 2013 and are engaged in micro finance will be permitted to avail of ECBs from international banks, multilateral financial institutions, export credit agencies, foreign equity holders, overseas organizations and individuals.

(5) A “foreign equity holder” to be eligible as “recognized lender” under the automatic route would require minimum holding of paid-up equity in the borrower company as set out below:

i. For ECB up to USD 5 million - minimum paid-up equity of 25 per cent held directly by the lender (all outstanding ECBs including the proposed one),

ii. For ECB more than USD 5 million - minimum paid-up equity of 25 per cent held directly by the lender and ECB liability-equity ratio not exceeding 4:1(all outstanding ECBs including the proposed one),

ECB from indirect equity holders is permitted provided the indirect equity holding in the Indian company by the lender is at least 51 per cent.

ECB from a group company is permitted provided both the borrower and the foreign lender are subsidiaries of the same parent.

Besides the paid-up capital, free reserves (including the share premium received in foreign currency) as per the latest audited balance sheet shall be reckoned for the purpose of calculating the ‘equity’ of the foreign equity holder in the term ECB liability-equity ratio. Where there are more than one foreign equity holders in the borrowing company, the portion of the share premium in foreign currency brought in by the lender(s) concerned shall only be considered for calculating the ECB liability-equity ratio for reckoning quantum of permissible ECB.

For calculating the ‘ECB liability’, not only the proposed borrowing but also the outstanding ECB from the same foreign equity holder lender shall be reckoned.

(6) Overseas organizations and individuals providing ECB need to comply with the following safeguards:

i. Overseas Organizations proposing to lend ECB would have to furnish to the AD bank of the
borrower a certificate of due diligence from an overseas bank, which, in turn, is subject to regulation of host-country regulator and adheres to the Financial Action Task Force (FATF) guidelines. The certificate of due diligence should comprise the following (i) that the lender maintains an account with the bank for at least a period of two years, (ii) that the lending entity is organised as per the local laws and held in good esteem by the business/local community and (iii) that there is no criminal action pending against it.

ii. Individual Lender has to obtain a certificate of due diligence from an overseas bank indicating that the lender maintains an account with the bank for at least a period of two years. Other evidence/documents such as audited statement of account and income tax return which the overseas lender may furnish need to be certified and forwarded by the overseas bank. Individual lenders from countries wherein banks are not required to adhere to Know Your Customer (KYC) guidelines are not eligible to extend ECB.

iii). Amount and Maturity

a. The maximum amount of ECB which can be raised by a corporate other than those in the hotel, hospital and software sectors, and corporate in miscellaneous services sector is USD 750 million or its equivalent during a financial year.

b. Corporates in the services sector viz. hotels, hospitals and software sector and miscellaneous services sector are allowed to avail of ECB up to USD 200 million or its equivalent in a financial year for meeting foreign currency and/ or Rupee capital expenditure for permissible end-uses. The proceeds of the ECBs should not be used for acquisition of land.

c. NGOs engaged in micro finance activities and Micro Finance Institutions (MFIs) can raise ECB up to USD 10 million or its equivalent during a financial year. Designated AD bank has to ensure that at the time of drawdown the forex exposure of the borrower is fully hedged.

d. NBFC-IFCs can avail of ECB up to 75 per cent of their owned funds (ECB including outstanding ECBs) and must hedge 75 per cent of their currency risk exposure.

e. NBFC-AFCs can avail of ECBs up to 75 per cent of their owned funds (ECB including outstanding ECBs) subject to a maximum of USD 200 million or its equivalent per financial year with a minimum maturity of 5 years and must hedge the currency risk exposure in full.

f. SIDBI can avail of ECB to the extent of 50 per cent of their owned funds including the outstanding ECB, subject to a ceiling of USD 500 million per financial year.

g. ECB up to USD 20 million or its equivalent in a financial year with minimum average maturity of three years. An illustration of average maturity period calculation is provided at Annex VI.

h. ECB above USD 20 million or equivalent and up to USD 750 million or its equivalent with a minimum average maturity of five years.

i. ECB up to USD 20 million or equivalent can have call/put option provided the minimum average maturity of three years is complied with before exercising call/put option.

j. All eligible borrowers can avail of ECBs designated in INR from ‘foreign equity holders’ as per the extant ECB guidelines.

k. NGOs engaged in micro finance activities can avail of ECBs designated in INR, from overseas organizations and individuals as per the extant guidelines.

iv) All-in-cost ceilings

All-in-cost includes rate of interest, other fees and expenses in foreign currency except commitment
fee, pre-payment fee, and fees payable in Indian Rupees. The payment of withholding tax in Indian Rupees is excluded for calculating the all-in-cost. The all-in-cost ceilings for ECB are reviewed from time to time.

v) End-use

a. ECB can be raised for investment such as import of capital goods (as classified by DGFT in the Foreign Trade Policy), new projects, modernization/expansion of existing production units in real sector - industrial sector including small and medium enterprises (SME), infrastructure sector and specified service sectors, viz. hotel, hospital and software and miscellaneous services sector as given at I(A)(i)(j) above. Infrastructure sector is defined as (a) Energy which will include (i) electricity generation, (ii) electricity transmission, (iii) electricity distribution, (iv) oil pipelines, (v) oil/gas/liquefied natural gas (LNG) storage facility (includes strategic storage of crude oil) and (vi) gas pipelines (includes city gas distribution network); (b) Communication which will include (i) mobile telephony services / companies providing cellular services, (ii) fixed network telecommunication (includes optic fibre / cable networks which provide broadband / internet) and (iii) telecommunication towers; (c) Transport which will include (i) railways (railway track, tunnel, viaduct, bridges and includes supporting terminal infrastructure such as loading / unloading terminals, stations and buildings), (ii) roads and bridges, (iii) ports, (iv) inland waterways, (v) airport and (vi) urban public transport (except rolling stock in case of urban road transport); (d) Water and sanitation which will include (i) water supply pipelines, (ii) solid waste management, (iii) water treatment plants, (iv) sewage projects (sewage collection, treatment and disposal system), (v) irrigation (dams, channels, embankments, etc.) and (vi) storm water drainage system; (e) (i) mining, (ii) exploration and (iii) refining; (f) Social and commercial infrastructure which will include (i) hospitals (capital stock and includes medical colleges and para medical training institutes), (ii) Hotel Sector which will include hotels with fixed capital investment of Rs. 200 crore and above, convention centres with fixed capital investment of Rs. 300 crore and above and three star or higher category classified hotels located outside cities with population of more than 1 million (fixed capital investment is excluding of land value), (iii) common infrastructure for industrial parks, SEZs, tourism facilities, (iv) fertilizer (capital investment), (v) post harvest storage infrastructure for agriculture and horticulture produce including cold storage, (vi) soil testing laboratories and (vii) cold chain (includes cold room facility for farm level pre-cooling, for preservation or storage or agriculture and allied produce, marine products and meat.

b. Overseas Direct Investment in Joint Ventures (JV)/ Wholly Owned Subsidiaries (WOS) subject to the existing guidelines on Indian Direct Investment in JV/ WOS abroad.

c. Utilization of ECB proceeds is permitted for first stage as well as subsequent stages of acquisition of shares in the disinvestment process to the public under the Government’s disinvestment programme of PSU shares.

d. Interest during Construction (IDC) for Indian companies which are in the infrastructure sector, where “infrastructure” is defined as per the extant ECB guidelines, subject to IDC being capitalized and forming part of the project cost.

e. For lending to self-help groups or for micro-credit or for bonafide micro finance activity including capacity building by NGOs engaged in micro finance activities.

f. NBFC-IFCs can avail of ECBs only for on-lending to the infrastructure sector as defined under the ECB policy.

g. NBFC-AFCs can avail of ECBs only for financing the import of infrastructure equipment for leasing to infrastructure projects.
h. Maintenance and operations of toll systems for roads and highways for capital expenditure provided they form part of the original project.

i. SIDBI can on lend to the borrowers in the MSME sector for permissible end uses, having natural hedge by way of foreign exchange earnings. SIDBI may on-lend either in INR or in foreign currency (FCY). In case of on-lending in INR, the foreign currency risk shall be fully hedged by SIDBI.

j. Refinancing of Bridge Finance (including buyers’ / suppliers’ credit) availed of for import of capital goods by companies in Infrastructure Sector

k. ECB is allowed for Import of services, technical know-how and payment of license fees. The companies in the manufacturing and infrastructure sectors may import services, technical know-how and payment of license fees as part of import of capital goods subject to certain conditions.

l. ECB for general corporate purposes from direct foreign equity holders by companies in manufacturing, infrastructure, hotels, hospitals and software sector: Eligible borrowers can avail ECB from their direct foreign equity holder company with a minimum average maturity of 7 years for general corporate purposes (which includes working capital) subject to the following conditions:
   i. Minimum paid-up equity of 25 per cent should be held directly by the lender;
   ii. Such ECBs would not be used for any purpose not permitted under extant the ECB guidelines (including on-lending to their group companies / step-down subsidiaries in India); and Repayment of the principal shall commence only after completion of minimum average maturity of 7 years.
   iii. No prepayment will be allowed before maturity.

vii) End-uses not permitted

Other than the purposes specified hereinabove, the borrowings shall not be utilized for any other purpose including the following purposes, namely:

(a) For on-lending or investment in capital market or acquiring a company (or a part thereof) in India by a corporate [investment in Special Purpose Vehicles (SPVs), Money Market Mutual Funds (MMMFs), etc., are also considered as investment in capital markets].

(b) for real estate sector,

(c) for general corporate purpose which includes working capital (other than what has been given at I(A)(v)(l) above) and repayment of existing rupee loans.

Note: The proceeds of the ECBs should not be used for acquisition of land.

viii) Guarantees

Issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by banks, Financial Institutions and Non-Banking Financial Companies (NBFCs) from India relating to ECB is not permitted.

ix) Security

The choice of security to be provided to the lender/supplier is left to the borrower. However, creation of charge over immovable assets and financial securities, such as shares, in favour of the overseas lender is subject to Regulation 8 of Notification No. FEMA 21/RB-2000 dated May 3, 2000 and Regulation 3 of Notification No. FEMA 20/RB-2000 dated May 3, 2000, respectively, as amended from time to time. AD Category - I banks have been delegated powers to convey ‘no objection’ under the Foreign Exchange Management Act (FEMA), 1999 for creation of charge on immovable assets, financial securities and issue of corporate or personal guarantees in favour of overseas lender / security trustee, to secure the ECB to be raised by the borrower.
x) Parking of ECB proceeds

Borrowers are permitted to either keep ECB proceeds abroad or to remit these funds to India, pending utilization for permissible end-uses.

The proceeds of the ECB raised abroad meant for Rupee expenditure in India, such as, local sourcing of capital goods, on-lending to Self-Help Groups or for micro credit, payment for spectrum allocation, etc. should be repatriated immediately for credit to the borrowers’ Rupee accounts with AD Category I banks in India. In other words, ECB proceeds meant only for foreign currency expenditure can be retained abroad pending utilization. The rupee funds, however, will not be permitted to be used for investment in capital markets, real estate or for inter-corporate lending.

ECB proceeds parked overseas can be invested in the following liquid assets (a) deposits or Certificate of Deposit or other products offered by banks rated not less than AA (-) by Standard and Poor/Fitch IBCA or Aa3 by Moody’s (b) Treasury bills and other monetary instruments of one year maturity having minimum rating as indicated above, and (c) deposits with overseas branches / subsidiaries of Indian banks abroad. The funds should be invested in such a way that the investments can be liquidated as and when funds are required by the borrower in India.

The primary responsibility to ensure that the ECB proceeds meant for Rupee expenditure in India are repatriated to India for credit to their Rupee accounts with AD Category-I banks in India is that of the borrower concerned and any contravention of the ECB guidelines will be viewed seriously and will invite penal action under the Foreign Exchange Management Act (FEMA), 1999. The designated AD bank is also required to ensure that the ECB proceeds meant for Rupee expenditure are repatriated to India immediately after drawdown.

xi) Prepayment

Prepayment of ECB up to USD 500 million may be allowed by AD banks without prior approval of Reserve Bank subject to compliance with the stipulated minimum average maturity period as applicable to the loan.

xii) Refinancing of an existing ECB

The existing ECB may be refinanced by raising a fresh ECB subject to the condition that the fresh ECB is raised at a lower all-in-cost and the outstanding maturity of the original ECB is maintained.

xiii) Debt Servicing

The designated AD bank has the general permission to make remittances of installments of principal, interest and other charges in conformity with the ECB guidelines issued by Government / Reserve Bank of India from time to time.

xiv) Corporates Under Investigation

All entities against which investigations / adjudications / appeals by the law enforcing agencies are pending may avail of ECBs as per the current norms, if they are otherwise eligible, notwithstanding the pending investigations / adjudications / appeals, without prejudice to the outcome of such investigations / adjudications / appeals. Accordingly, in case of all applications where the borrowing entity has indicated about the pending investigations / adjudications / appeals, Authorised Dealers while approving the proposal shall intimate the concerned agencies by endorsing the copy of the approval letter.

xv) Procedure

Borrowers may enter into loan agreement complying with the ECB guidelines with recognised lender for raising ECB under the Automatic Route without the prior approval of the Reserve Bank. The borrower must obtain a Loan Registration Number (LRN) from the Reserve Bank of India before drawing down the ECB.
i) Eligible Borrowers

The following types of proposals for ECB are covered under the Approval Route:

a. On lending by the EXIM Bank for specific purposes will be considered on a case by case basis.

b. Banks and financial institutions which had participated in the textile or steel sector restructuring package as approved by the Government are also permitted to the extent of their investment in the package and assessment by the Reserve Bank based on prudential norms. Any ECB availed for this purpose so far will be deducted from their entitlement.

c. ECB with minimum average maturity of 5 years by Non-Banking Financial Companies (NBFCs) from multilateral financial institutions, reputable regional financial institutions, official export credit agencies and international banks to finance import of infrastructure equipment for leasing to infrastructure projects.

d. NBFCs-IFCs are permitted to avail of ECB, beyond 75 per cent of their owned funds (including the outstanding ECBs) for on-lending to the infrastructure sector as defined under the ECB policy.

e. NBFCs-AFCs are permitted to avail of ECB, beyond 75 per cent of their owned funds (including outstanding ECBs) to finance the import of infrastructure equipment for leasing to infrastructure projects.

f. Foreign Currency Convertible Bonds (FCCBs) by Housing Finance Companies satisfying the following minimum criteria: (i) the minimum net worth of the financial intermediary during the previous three years shall not be less than Rs. 500 crore, (ii) a listing on the BSE or NSE, (iii) minimum size of FCCB is USD 100 million and (iv) the applicant should submit the purpose / plan of utilization of funds.

g. Special Purpose Vehicles, or any other entity notified by the Reserve Bank, set up to finance infrastructure companies / projects exclusively, will be treated as Financial Institutions and ECB by such entities will be considered under the Approval Route.

h. Multi-State Co-operative Societies engaged in manufacturing activity and satisfying the following criteria: i) the Co-operative Society is financially solvent and ii) the Co-operative Society submits its up-to-date audited balance sheet.

i. SEZ developers can avail of ECBs for providing infrastructure facilities within SEZ, as defined in the extant ECB policy (as given at I(A)(v)(a) above).

j. Developers of National Manufacturing Investment Zones (NMiZs) can avail of ECB for providing infrastructure facilities within SEZ, as defined in the extant ECB policy (as given at I(A)(v)(a) above).

k. Eligible borrowers under the automatic route other than corporates in the services sector viz. hotel, hospital and software can avail of ECB beyond USD 750 million or equivalent per financial year.

l. Corporates in the services sector viz. hotels, hospitals, and software sectors and in miscellaneous services (as given at I(A)(i)(l) above) can avail of ECB beyond USD 200 million or equivalent per financial year. ECB for corporates in miscellaneous services is permitted only from direct / indirect equity holders and group companies. Small Industries Development Bank of India (SIDBI) is eligible to avail of ECB for on-lending to MSME sector, as defined under the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, beyond 50 per cent of their owned funds, subject to a ceiling of USD 500 million per financial year provided such on-lending by SIDBI shall be to the borrowers’ for permissible end-use and having natural hedge by way of foreign exchange earnings.
SIDBI may on-lend either in INR or in foreign currency (FCY). In case of on-lending in INR, the foreign currency risk shall be fully hedged by SIDBI.

m. Low Cost Affordable Housing Projects: Developers/builders / Housing Finance Companies (HFCs) / National Housing Bank (NHB) may avail of ECB for low cost affordable housing projects [refer to para I B (vii) ibid]. Corporates under Investigation: All entities against which investigations / adjudications / appeals by the law enforcing agencies are pending, may avail of ECBs as per the current norms, if they are otherwise eligible, notwithstanding the pending investigations / adjudications / appeals, without prejudice to the outcome of such investigations / adjudications / appeals. Accordingly, in case of all applications where the borrowing entity has indicated about the pending investigations / adjudications / appeals, the Reserve Bank of India while approving the proposal shall intimate the concerned agencies by endorsing the copy of the approval letter.

n. Holding Companies / Core Investment Companies (CICs) coming under the regulatory framework of the Reserve Bank are permitted to raise ECB for project use in Special Purpose Vehicles (SPVs) provided the business activity of the SPV is in the infrastructure sector where “infrastructure” is defined as per the extant ECB guidelines. The infrastructure project is required to be implemented by the SPV established exclusively for implementing the project and is subject to conditions. In case of Holding Companies that come under the Core Investment Company (CIC) regulatory framework of the Reserve Bank, the ECB availed should be within the ceiling of leverage stipulated for CICs and in case of CICs with asset size below Rs. 100 crore, the ECB availed should be on fully hedged basis.

o. Cases falling outside the purview of the automatic route limits and maturity period as indicated at paragraph I A (iii).

ii) Recognised Lenders

(a) Borrowers can raise ECB from internationally recognised sources, such as (i) international banks, (ii) international capital markets, (iii) multilateral financial institutions (such as IFC, ADB, CDC, etc.)/ regional financial institutions and Government owned development financial institutions, (iv) export credit agencies, (v) suppliers’ of equipment, (vi) foreign collaborators and (vii) foreign equity holders (other than erstwhile OCBs). Overseas branches / subsidiaries of Indian banks are not recognised as lenders in case the end use is repayment / refinance of Rupee loans raised from domestic banking system under any of the schemes under the ECB policy.

(b) A “foreign equity holder” to be eligible as “recognized lender” under the approval route would require minimum holding of paid-up equity in the borrower company as set out below:

(i) For ECB up to USD 5 million - minimum paid-up equity of 25 per cent held directly by the lender (all outstanding ECBs including the proposed one);

(ii) For ECB more than USD 5 million - minimum paid-up equity of 25 per cent held directly by the lender and ECB liability-equity ratio not exceeding 7:1 (all outstanding ECBs including the proposed one);

(c) ECB from indirect equity holders provided the indirect equity holding by the lender in the Indian company is at least 51 per cent;

(d) ECB from a group company provided both the borrower and the foreign lender are subsidiaries of the same parent.

Besides the paid-up capital, free reserves (including the share premium received in foreign currency) as per the latest audited balance sheet shall be reckoned for the purpose of calculating the ‘equity’ of the foreign equity holder in the term ECB liability-equity ratio. Where there are more than one foreign equity
holder in the borrowing company, the portion of the share premium in foreign currency brought in by the lender(s) concerned shall only be considered for calculating the ECB liability-equity ratio for reckoning quantum of permissible ECB.

For calculating the ‘ECB liability’, not only the proposed borrowing but also the outstanding ECB from the same foreign equity holder lender shall be reckoned.

The total outstanding stock of ECBs (including the proposed ECBs) from a foreign equity lender should not exceed seven times the equity holding, either directly or indirectly of the lender (in case of lending by a group company, equity holdings by the common parent would be reckoned).

iii) Amount and Maturity

Eligible borrowers under the automatic route other than corporates in the services sector viz. hotel, hospital, software and miscellaneous services can avail of ECB beyond USD 750 million or equivalent per financial year. Corporates in the services sector viz. hotels, hospitals, software sector and miscellaneous services are allowed to avail of ECB beyond USD 200 million or its equivalent in a financial year for meeting foreign currency and/or Rupee capital expenditure for permissible end-uses. The proceeds of the ECBs should not be used for acquisition of land.

iv) All-in-cost ceilings

All-in-cost includes rate of interest, other fees and expenses in foreign currency except commitment fee, pre-payment fee and fees payable in Indian Rupees. The payment of withholding tax in Indian Rupees is excluded for calculating the all-in-cost. The all-in-cost ceilings for ECB are reviewed from time to time.

v) End-use

a. ECB can be raised only for investment [such as import of capital goods (as classified by DGFT in the Foreign Trade Policy), implementation of new projects, modernization/expansion of existing production units] in the real sector - industrial sector including small and medium enterprises (SME) and infrastructure sector - in India. Infrastructure sector is as given at I(A)(v)(a) above.

b. Overseas Direct Investment in Joint Ventures (JV)/Wholly Owned Subsidiaries (WOS) subject to the existing guidelines on Indian Direct Investment in JV/WOS abroad.

c. Interest During Construction (IDC) for Indian companies which are in the infrastructure sector, as defined under the extant ECB guidelines subject to IDC being capitalized and forming part of the project cost.

d. The payment by eligible borrowers in the Telecom sector, for spectrum allocation may, initially, be met out of Rupee resources by the successful bidders, to be refinanced with a long-term ECB, under the approval route, subject to the following conditions:
   i. The ECB should be raised within 12 months from the date of payment of the final instalment to the Government;
   ii. The designated AD - Category I bank should monitor the end-use of funds;
   iii. Banks in India will not be permitted to provide any form of guarantees; and
   iv. All other conditions of ECB, such as eligible borrower, recognized lender, all-in-cost, average maturity, etc. should be complied with.

   v. ECB should not be raised from overseas branches / subsidiaries of Indian banks.

e. The first stage as well as subsequent stages of acquisition of shares in the disinvestment process to the public under the Government’s disinvestment programme of PSU shares.
f. Repayment of Rupee loans availed of from domestic banking system: Indian companies which are in the infrastructure sector (except companies in the power sector), as defined under the extant ECB guidelines, are permitted to utilise 25 per cent of the fresh ECB raised by them towards refinancing of the Rupee loan/s availed by them from the domestic banking system, subject to the following conditions:

(i) at least 75 per cent of the fresh ECB proposed to be raised should be utilised for capital expenditure towards a ‘new infrastructure’ project(s)

(ii) in respect of remaining 25 per cent, the refinance shall only be utilized for repayment of the Rupee loan availed of for ‘capital expenditure’ of earlier completed infrastructure project(s); and

(iii) the refinance shall be utilized only for the Rupee loans which are outstanding in the books of the financing bank concerned.

(iv) ECB should not be raised from overseas branches / subsidiaries of Indian banks.

Companies in the power sector are permitted to utilize up to 40 per cent of the fresh ECB raised by them towards refinancing of the Rupee loan/s availed by them from the domestic banking system subject to the condition that at least 60 per cent of the fresh ECB proposed to be raised should be utilized for fresh capital expenditure for infrastructure project(s).

g. ECB is allowed for Import of services, technical know-how and payment of license fees. The companies in the manufacturing and infrastructure sectors may import services, technical know-how and payment of license fees as part of import of capital goods subject to certain conditions.

h. Bridge Finance: Indian companies which are in the infrastructure sector, as defined under the extant ECB policy are permitted to import capital goods by availing of short term credit (including buyers’ / suppliers’ credit) in the nature of ‘bridge finance’, with RBI’s prior approval provided the bridge finance shall be replaced with a long term ECB as per extant ECB guidelines.

i. ECB for working capital for civil aviation sector: Airline companies registered under the Companies Act, 2013 and possessing scheduled operator permit license from DGCA for passenger transportation are eligible to avail of ECB for working capital. Such ECBs will be allowed based on the cash flow, foreign exchange earnings and the capability to service the debt and the ECBs can be raised with a minimum average maturity period of three years.

The overall ECB ceiling for the entire civil aviation sector would be USD one billion and the maximum permissible ECB that can be availed by an individual airline company will be USD 300 million. This limit can be utilized for working capital as well as refinancing of the outstanding working capital Rupee loan(s) availed of from the domestic banking system. ECB availed for working capital/ refinancing of working capital as above will not be allowed to be rolled over. The foreign exchange for repayment of ECB should not be accessed from Indian markets and the liability should be extinguished only out of the foreign exchange earnings of the borrowing company. The scheme will be available upto March 31, 2015.

j. ECB for general corporate purposes from direct foreign equity holders: Eligible borrowers can avail ECB under approval route from their direct foreign equity holder company with a minimum average maturity of 7 years for general corporate purposes (which includes working capital) subject to the following conditions:

i. Minimum paid-up equity of 25 per cent should be held directly by the lender;

ii. Such ECBs would not be used for any purpose not permitted under extant the ECB guidelines (including on-lending to their group companies / step-down subsidiaries in India); and
iii. Repayment of the principal shall commence only after completion of minimum average maturity of 7 years. No prepayment will be allowed before maturity.

iv. Repayment of Rupee loans and/or fresh Rupee capital expenditure for companies with consistent forex earnings – USD 10 billion scheme
   a) Indian companies in the manufacturing, infrastructure sector and hotel sector (with a total project cost of INR 250 crore or more irrespective of geographical location for hotel sector), can avail of ECBs for repayment of outstanding Rupee loans availed of for capital expenditure from the domestic banking system and/or fresh Rupee capital expenditure provided they are consistent foreign exchange earners during the past three financial years and not in the default list/caution list of the Reserve Bank of India.

vi) End-uses not permitted

Other than the purposes specified hereinabove, the borrowings shall not be utilised for any other purpose including the following purposes, namely:

(a) For on-lending or investment in capital market or acquiring a company (or a part thereof) in India by a corporate except Infrastructure Finance Companies (IFCs), banks and financial institutions eligible.

(b) For real estate.

(c) For and general corporate purpose which includes working capital [except as stated at I(B)(v)(i) and (j)] and repayment of existing Rupee loans.

vii) Guarantee

Issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by banks, financial institutions and NBFCs relating to ECB is not normally permitted. Applications for providing guarantee/standby letter of credit or letter of comfort by banks, financial institutions relating to ECB in the case of SME will be considered on merit subject to prudential norms.

With a view to facilitating capacity expansion and technological upgradation in Indian textile industry, issue of guarantees, standby letters of credit, letters of undertaking and letters of comfort by banks in respect of ECB by textile companies for modernization or expansion of textile units will be considered under the Approval Route subject to prudential norms.

viii) Security

The choice of security to be provided to the lender / supplier is left to the borrower. However, creation of charge over immovable assets and financial securities, such as shares, in favour of the overseas lender is subject to Regulation 8 of Notification No. FEMA 21/RB-2000 dated May 3, 2000 and Regulation 3 of Notification No. FEMA 20/RB-2000 dated May 3, 2000 as amended from time to time, respectively. Powers have been delegated to Authorised Dealer Category I banks to issue necessary NOCs under FEMA Regulations.

ix) Parking of ECB proceeds

Borrowers are permitted to either keep ECB proceeds abroad or to remit these funds to India, pending utilization for permissible end-uses.

The proceeds of the ECB raised abroad meant for Rupee expenditure in India, such as, local sourcing of capital goods, on-lending to Self-Help Groups or for micro credit, payment for spectrum allocation, repayment of rupee loan availed from domestic banks, etc. should be repatriated immediately for credit to their Rupee accounts with AD Category I banks in India. In other words, ECB proceeds meant only for foreign currency expenditure can be retained abroad pending utilization. The rupee
funds, however, will not be permitted to be used for investment in capital markets, real estate or for inter-corporate lending.

ECB proceeds parked overseas can be invested in the following liquid assets (a) deposits or Certificate of Deposit or other products offered by banks rated not less than AA (-) by Standard and Poor/ Fitch IBCA or Aa3 by Moody’s; (b) Treasury bills and other monetary instruments of one year maturity having minimum rating as indicated above and (c) deposits with overseas branches / subsidiaries of Indian banks abroad. The funds should be invested in such a way that the investments can be liquidated as and when funds are required by the borrower in India.

The primary responsibility to ensure that the ECB proceeds meant for Rupee expenditure in India are repatriated to India for credit to their Rupee accounts with AD Category- I banks in India is that of the borrower concerned and any contravention of the ECB guidelines will be viewed seriously and will invite penal action under the Foreign Exchange Management Act (FEMA), 1999. The designated AD bank is also required to ensure that the ECB proceeds meant for Rupee expenditure are repatriated to India immediately after drawdown.

x) Prepayment

(a) Prepayment of ECB beyond USD 500 million will be considered by the Reserve Bank subject to compliance with the stipulated minimum average maturity period as applicable to the loan. would be considered by the Reserve Bank under the Approval Route.

xi) Refinancing/rescheduling of an existing ECB

The cases where the existing ECB is proposed to be refinanced by raising a fresh ECB at a lower all-in-cost are considered under the approval route if the average maturity period of the fresh ECB is more than the residual maturity of the existing ECB.

xii) Debt Servicing

The designated AD bank has general permission to make remittances of installments of principal, interest and other charges in conformity with the ECB guidelines issued by Government / Reserve Bank from time to time.

xiii) Procedure

Applicants are required to submit an application in form ECB through designated AD bank to the Chief General Manager-in-Charge, Foreign Exchange Department, Reserve Bank of India, Central Office, External Commercial Borrowings Division, Mumbai – 400 001, along with necessary documents.

xiv) Empowered Committee

Reserve Bank has set up an Empowered Committee to consider proposals coming under the Approval Route.

CONVERSION OF ECB INTO EQUITY

(i) Conversion of ECB into equity is permitted subject to the following conditions:

a. The activity of the company is covered under the Automatic Route for Foreign Direct Investment or Government (FIPB) approval for foreign equity participation has been obtained by the company, wherever applicable.

b. The foreign equity holding after such conversion of debt into equity is within the sectoral cap, if any.

c. Pricing of shares is as per the pricing guidelines issued under FEMA, 1999 in the case of listed/ unlisted companies.
d. Conversion of ECB and Lumpsum Fee / Royalty into Equity: In case the ECB liability, denominated in foreign currency and/or import of capital goods, etc. is sought to be converted by the company, it will be in order to apply the exchange rate prevailing on the date of the agreement between the parties concerned for such conversion. Reserve Bank will have no objection if the borrower company wishes to issue equity shares for a rupee amount less than that arrived at as mentioned above by a mutual agreement with the ECB lender. It may be noted that the fair value of the equity shares to be issued shall be worked out with reference to the date of conversion only. The principle of calculation of INR equivalent for a liability denominated in foreign currency as mentioned above shall apply, mutatis mutandis, to all cases where any payables/liability by an Indian company such as, lump sum fees/royalties, etc. are permitted to be converted to equity shares or other securities to be issued to a non-resident subject to the conditions stipulated under the respective Regulations.

(ii) Conversion of ECB may be reported to the Reserve Bank as follows:

   a. Borrowers are required to report full conversion of outstanding ECB into equity in the form FC-GPR to the Regional Office concerned of the Reserve Bank as well as in form ECB-2 submitted to the DSIM, RBI within seven working days from the close of month to which it relates. The words “ECB wholly converted to equity” should be clearly indicated on top of the ECB-2 form. Once reported, filing of ECB-2 in the subsequent months is not necessary.

   b. In case of partial conversion of outstanding ECB into equity, borrowers are required to report the converted portion in form FC-GPR to the Regional Office concerned as well as in form ECB-2 clearly differentiating the converted portion from the unconverted portion. The words “ECB partially converted to equity” should be indicated on top of the ECB-2 form. In subsequent months, the outstanding portion of ECB should be reported in ECB-2 form to DSIM.
LESSON 12

INDIAN DEPOSITORY RECEIPTS

RULE 13 OF THE COMPANIES (REGISTRATION OF FOREIGN COMPANIES) RULES, 2014

These rules are applicable to those companies incorporated outside India, whether they have or have not, or will or will not, establish any place of business in India.

For the purposes of section 390, no company incorporated or to be incorporated outside India, whether the company has or has not established, or may or may not establish, any place of business in India (hereinafter in this rule called ‘issuing company’) shall make an issue of Indian Depository Receipts (IDRs) unless such company complies with the conditions mentioned under this rule, in addition to the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 and any directions issued by the Reserve Bank of India.

ELIGIBILITY FOR ISSUE OF IDRs

Sub-rule 2 stipulates that the issuing company shall not issue IDRs unless-
(a) its pre-issue paid-up capital and free reserves are at least US$ 50 million and it has a minimum average market capitalization (during the last three years) in its parent country of at least US$ 100 million;
(b) it has been continuously trading on a stock exchange in its parent or home country (the country of incorporation of such company) for at least three immediately preceding years;
(c) it has a track record of distributable profits in terms of section 123 of the Act, for at least three out of immediately preceding five years;
(d) It fulfills such other eligibility criteria as may be laid down by the Securities and Exchange Board of India from time to time in this behalf.

PROCEDURE FOR MAKING AN ISSUE OF IDRs

Sub-rule 3 lays down the procedure for making an issue of IDRs. The issuing company shall follow the following procedure for making an issue of IDRs:
(a) the issuing company shall, where required, obtain the necessary approvals or exemptions from the appropriate authorities from the country of its incorporation under the relevant laws relating to issue of capital and IDRs.
(b) issuing company shall obtain prior written approval from SEBI on an application made in this behalf for issue of IDRs along with the issue size.
(c) an application under clause (b) shall be made to SEBI (along with draft prospectus) at least ninety days prior to the opening date of the IDRs issue, in such form, along with such fee and furnishing such information as may be specified by the Securities and Exchange Board of India from time to time:
However, the issuing company shall also file with SEBI, through a Merchant Banker, a due diligence report along with the application under clause (b) in the form specified by SEBI.
(d) SEBI may, within a period of thirty days of receipt of an application under clause (c), call for such further information, and explanations, as it may deem necessary, for disposal of such
application and shall dispose the application within a period of thirty days of receipt of further information or explanation.
However, if within a period of sixty days from the date of submission of application or draft prospectus, SEBI specifies any changes to be made in the draft prospectus, the prospectus shall not be filed with SEBI or Registrar of Companies unless such changes have been incorporated therein.
(e) the issuing company shall on approval being granted by the Securities and Exchange Board of India to an application under clause (b), pay to the Securities and Exchange Board of India an issue fee as may be prescribed from time to time by the Securities and Exchange Board of India.
(f) the issuing company shall file a prospectus, certified by two authorized signatories of the issuing company, one of whom shall be a whole-time director and other the Chief Financial Officer, stating the particulars of the resolution of the Board by which it was approved with SEBI and Registrar of Companies, New Delhi before such issue.
However, at the time of filing of said prospectus with the Registrar of Companies, New Delhi, a copy of approval granted by SEBI and the statement of fees paid by the Issuing Company to SEBI shall also be attached.
(g) the prospectus to be filed with SEBI and the Registrar of Companies, New Delhi shall contain the particulars as prescribed in sub-rule (8) and shall be signed by all the whole-time directors of the issuing company, and the Chief Financial Officer.
(h) the issuing company shall appoint an overseas custodian bank, a Domestic Depository and a Merchant Banker for the purpose of issue of IDRs.
(i) the issuing company may appoint underwriters registered with SEBI to underwrite the issue of IDRs.
(j) the issuing company shall deliver the underlying equity shares or cause them to be delivered to an Overseas Custodian Bank and the said bank shall authorize the domestic depository to issue IDRs.
(k) the issuing company shall obtain in-principle listing permission from one or more stock exchanges having nationwide trading terminals in India.

REGISTRATION OF DOCUMENTS
Sub-rule 4 provides that the Merchant Banker to the issue of IDRs shall deliver for registration the following documents or information to SEBI and Registrar of Companies at New Delhi, namely:-
(a) instrument constituting or defining the constitution of the issuing company;
(b) the enactments or provisions having the force of law by or under which the incorporation of the Issuing company was effected, a copy of such provisions attested by an officer of the company be annexed;
(c) if the issuing company has established place of business in India, address of its principal office in India;
(d) if the issuing company does not establish a principal place of business in India, an address in India where the said instrument, enactments or provision or copies thereof are available for public inspection, and if these are not in English, a translation thereof certified by a key managerial personnel of the Issuing company shall be kept for public inspection;
(e) a certified copy of the certificate of incorporation of the issuing company in the country in which it is incorporated;
(f) the copies of the agreements entered into between the issuing company, the overseas custodian bank, the Domestic Depository, which shall inter alia specify the rights to be passed on to the IDR holders;
(g) if any document or any portion thereof required to be filed with SEBI or the Registrar of Companies is not in English language, a translation of that document or portion thereof in English, certified by a key managerial personnel of the company to be correct and attested by an authorized officer of the Embassy or Consulate of that country in India, shall be attached to each copy of the document.

CONDITIONS FOR ISSUE OF PROSPECTUS AND APPLICATION
Sub-rule 5 deals with conditions required to be fulfilled for issue of prospectus which is as under:
(a) No application form for the securities of the issuing company shall be issued unless the form is accompanied by a memorandum containing the salient features of prospectus in the specified form.
(b) An application form can be issued without the memorandum as specified in clause (a), if it is issued in connection with an invitation to enter into an underwriting agreement with respect to the IDRs.
(c) The prospectus for subscription of IDRs of the Issuing company which includes a statement purporting to be made by an expert shall not be circulated, issued or distributed in India or abroad unless a statement that the expert has given his written consent to the issue thereof and has not withdrawn such consent before the delivery of a copy of the prospectus to SEBI and the Registrar of Companies, New Delhi, appears on the prospectus.
(d) The provisions of the Act shall apply for all liabilities for mis-statements in prospectus or punishment for fraudulently inducing persons to invest money in IDRs.
(e) The person(s) responsible for issue of the prospectus shall not incur any liability by reason of any non-compliance with or contravention of any provision of this rule, if-
(i) as regards any matter not disclosed, he proves that he had no knowledge thereof; or
(ii) the contravention arose in respect of such matters which in the opinion of the Central Government or SEBI were not material.

PROCEDURE FOR TRANSFER AND REDEMPTION
Sub-rule 6 narrates the procedure for transfer and redemption of IDRS.
(a) A holder of IDRs may transfer the IDRs, may ask the Domestic Depository to redeem them or any person may seek reissuance of IDRs by conversion of underlying equity shares, subject to the provisions of the Foreign Exchange Management Act, 1999, the SEBI Act, 1992, or the rules, regulations or guidelines issued under these Acts, or any other law for the time being in force;
(b) In case of redemption, Domestic Depository shall request the Overseas Custodian Bank to get the corresponding underlying equity shares released in favour of the holder of IDRs for being sold directly on behalf of holder of IDRs, or being transferred in the books of Issuing company in the name of holder of IDRs and a copy of such request shall be sent to the issuing company for information.
(c) A holder of IDRs may, at any time, nominate a person to whom his IDRs shall vest in the event of his death and Form FC-5 may be used for this purpose.
Sub-rule 7 provides for repatriation of issue proceeds of IDRS.

(a) The repatriation of the proceeds of issue of IDRs shall be subject to laws for the time being in force relating to export of foreign exchange.

(b) The number of underlying equity shares offered in a financial year through IDR offerings shall not exceed twenty five per cent. of the post issue number of equity shares of the company.

(c) Notwithstanding the denomination of securities of an Issuing company, the IDRs issued by it shall be denominated in Indian Rupees.

(d) The IDRs issued under this Rule shall be listed on the recognized Stock Exchange(s) in India as specified in clause (k) of sub-rule (3) and such IDRs may be purchased, possessed and freely transferred by a person resident in India as defined in section 2(v) of the Foreign Exchange Management Act, 1999, subject to the provisions of the said Act.

Provided that the IDRs issued by an Issuing company may be purchased, possessed and transferred by a person other than a person resident in India if such Issuing company obtains specific approval from Reserve Bank of India in this regard or complies with any policy or guidelines that may be issued by Reserve Bank of India on the subject matter;

(e) Every issuing company shall comply with such continuous disclosure requirements as may be specified by SEBI in this regard.

(f) On the receipt of dividend or other corporate action on the IDRs as specified in the agreements between the Issuing company and the Domestic Depository, the Domestic Depository shall distribute them to the IDR holders in proportion to their holdings of IDRs.
LESSON 14
SECURITIES AND EXCHANGE BOARD OF INDIA

SEBI (Settlement of Administrative & Civil Proceedings) Regulations, 2014

Under the SEBI Act, 1992, Securities Contracts (Regulation) Act, 1956 (SCRA) and the Depositories Act, 1996, SEBI pursues two streams of enforcement actions i.e. Administrative/Civil or Criminal. Administrative/civil actions include issuing directions such as remedial orders, cease and desist orders, suspension or cancellation of certificate of registration and imposition of monetary penalty under the respective statutes and action pursued or defended in a court of law/tribunal. Criminal action involves initiating prosecution proceedings against violators by filing complaint before a criminal court. Consent order is a remedial measure for settling civil proceedings initiated by SEBI.

Consent Order means an order settling administrative or civil proceedings between the regulator and a person (Party) who may prima facie be found to have violated securities laws. Consent Order provides flexibility of wider array of enforcement and remedial actions which will achieve the twin goals of an appropriate sanction, remedy and deterrence without resorting to litigation, lengthy proceedings and consequent delays.

SEBI vide circular ref no. EFD/ED/Cir-1/2007 dated April 20, 2007 laid down the framework for passing of consent orders and for considering requests for composition of offences under SEBI Act, SC(R) Act and Depositories Act. Again in the year 2012 SEBI with the purpose of providing more clarity on its scope and applicability, partially modified the same.


The said Ordinance provided that SEBI may, after taking into consideration the nature, gravity and impact of defaults, agree to the proposal for settlement, on payment of such sum by the defaulter or on such other terms as may determined by SEBI in accordance with the regulations made under SEBI Act. The said Ordinance further provided that the settlement proceedings shall be conducted in accordance with the procedure specified in the regulations made under SEBI Act. In this direction SEBI also placed a draft consultation paper on SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2013 on its website for public comments.

In the light of the above, SEBI framed SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2014 and notified it vide Circular No. LAD-NRO/GN/2013-14/37/50 dated 09 January, 2014. These regulations will enable the persons who have defaulted on any SEBI laws & civil proceedings have been initiated against them, to settle the proceedings. These regulations do not provide for settling proceedings which are under criminal in nature.
These regulations provide for the involved entity to file settlement plea within 60 days of the show cause notice served to them by SEBI. The charges and related costs would not be considered upon the payment of settlement also in the cases in which the applicant has already been a party to two earlier settlements. The regulation mentions the minimum amount to be paid by entities, which will vary as per the charges against them. These charges will be highest for the promoters.

The SEBI (Settlement of Administrative & Civil Proceedings) Regulations, 2014 is divided into VIII chapters and two schedules. Chapter 1 covers the preliminary definitions part. Chapter II deals with the application for settlement and limitations part. Chapter III stipulates the scope of settlement proceedings, withdrawal of application for settlement, effect of pending application on the specified proceedings etc, Chapter V deals with the terms of settlement like monetary and non- monetary terms, factors to be considered to arrive at the settlement terms, Chapter V defined the role of the internal committee and high powered advisory committee in order to impart transparency in the process, Chapter VI provides the procedure of settlement before the internal committee and high powered advisory committee, Chapter VII deals with Settlement orders like settlement of proceeding before the adjudicating officer and SEBI or Settlement proceeding pending before tribunal or any court, Rejection of application in certain eventualities and chapter VIII deals with miscellaneous information like confidentiality of information, power to remove difficulties, SEBI’s power to specify procedures, Rescission and savings etc. Schedule I is divided into three parts A, B & C respectively and Schedule II is again divided into seven chapters.

The highlights of the Regulations in brief is discussed below:

Scope of Settlement Proceeding

Regulation 5 deals with the scope settlement proceedings. It provides that an application for settlement of any specified proceeding shall not be considered, if:

(a) the alleged default was committed within a period of 24 calendar months from the date of the last settlement order where the applicant was a party.
(b) An earlier application with regard to the same alleged default has been rejected;
(c) the applicant has been party to two settlement orders during the period of thirty six calendar months, prior to the date of applications;
(d) the audit or investigation, if any, in respect of any alleged default, is not complete.

The following proceedings are out of the scope of this regulations, i.e. a specified proceeding cannot be settled, if it involves any of the following defaults:

a) defaults involving insider trading and communication of unpublished price sensitive information;

(b) fraudulent and unfair trade practices including front running, which in the opinion of SEBI are serious and have a market wide impact or have caused substantial losses to or affect the rights of investors in securities, especially retail investors and small shareholders:
Explanation.- The expression 'front running' means usage of non-public information to directly or indirectly, buy or sell securities or enter into options or futures contracts, in advance of a substantial order, on an impending transaction, in the same or related securities or futures or options contracts, in anticipation that when the information becomes public; the price of such securities or contracts may change;

(c) failure to make an open offer except where the applicant agrees to make the open offer or where SEBI is of the opinion that the making of the open offer would not be beneficial to the shareholders or is infructuous;

(d) defaults or manipulative practices by mutual funds, alternative investment funds, collective investment schemes and their sponsors or asset management companies, collective investment management company, managers, trustees that result in substantial losses to investors, except in cases where the applicant has compensated the investors for the losses, to the satisfaction of SEBI;

(e) failure to redress investor grievances except where the alleged default is with regard to delayed redressal;

(f) failure, by issuers of securities or entities who invite investment, to make material disclosures in offer documents;

(g) raising of monies by issuance of securities or pooling of funds, in violation of securities laws where the remedy is refund of such monies;

(h) non-compliance of notices and summons issued by SEBI or summons issued by the adjudicating officer;

(i) non-compliance of any order or direction passed under the securities laws.

So any civil proceedings apart from above can be brought under these regulations & can be settled.

Settlement Terms

Regulation 8 provides for the terms of settlement in monetary as well as non-monetary terms or both. The non-monetary terms may include appropriate directions, such as:

a) Voluntary suspension of certificate of registration or closure of business for a specified period;
(b) Removal from Management;
(c) Direction in the nature of disgorgement, where it is possible to identify the investors who have incurred losses on account of the action or inaction of the applicant;
(d) Debarment of certain individuals from acting as a partner or officer or director of an intermediary or as an officer or director of a company that has a class of securities regulated by SEBI, for specified periods;
(e) Cancellation of securities and reduction in shareholding where the securities are issued fraudulently including cancellation of bonus shares received on such securities, if any, and reimbursement of any dividends received, etc;
(f) Voluntary lock-in of securities;
(g) Implementation of enhanced policies and procedures to prevent future securities laws violations as well as direction to appoint or retain an independent consultant to review policies and procedures;
(h) Direction to provide enhanced training and education to employees of intermediaries;
(i) Directions relating to internal audit and reporting requirements;
(j) Any other directions that may be issued by SEBI under the securities laws in the interest of the investors.

The amount of settlement will be credited in the Consolidated Fund of India and the legal cost will be included in the general fund of SEBI. The ill-gotten profits made (if any) will be credited in SEBI’s Investor Protection and Education Fund.

Factors to be considered to arrive at the settlement terms

Regulation 9 deals with the factors to be considered by SEBI while arriving at the settlement terms, including but not limited to the following:
(a) conduct of the applicant in the investigation;
(b) the role played by the applicant in case the alleged default is committed by a group of persons;
(c) nature, gravity and impact of alleged defaults;
(d) whether any other proceeding against the applicant for non-compliance of securities laws is pending or concluded;
(e) whether the alleged default is minor or major in nature;
(f) the extent of amount of harm and/or loss to investors’ and/or gain by the applicant;
(g) processes which have been introduced since the alleged default to minimize future defaults or lapses;
(h) compliance schedule proposed by the applicant;
(i) economic benefits accruing to any person from the non-compliance or delayed compliance;
(j) conditions which are necessary to deter future non-compliance by the same or another person;
(k) satisfaction of claim of investors regarding payment of money due to them or delivery of securities to them;
(l) whether the applicant has undergone any other enforcement action for the same violation;
(m) any other factors necessary in the facts and circumstances of the case.

Procedure

1. The person who wants to have proceedings settled have to make application along with requisite fees.

2. The applicant shall make full & true disclosures.
3. Application should be complete & if not complete it will be returned. The return of application can be resubmitted within 15 days from the day of rejection of application.

4. The Settlement terms include settlement amount &/or non-monetary terms. The Settlement Amount will be calculated in accordance with the guidelines specified in Schedule II of these regulations.

5. The settlement once completed will be published on SEBI website.

6. If there is any non compliance of settlement order then the original proceedings which was settled would be restored.

7. The application may be rejected if applicant refuses to receive or respond to the communications sent by SEBI or non submission or delays the submission of information, document, etc. as required or non appearance before the internal committee on more than one occasion or violates in any manner the undertaking and waivers specified, or non remittance or delays the payment of settlement amount and/or does not abide by the undertaking and waivers.

SEBI (Procedure for Search and Seizure) Regulations, 2014

The Securities Laws (Amendment) Second Ordinance, 2013 was promulgated on September 16, 2013 conferring explicit powers on the Chairman, SEBI to authorise Investigating Authority or any other officer of SEBI to conduct search and seizure under sub-section (8) of section 11C of the SEBI Act, 1992.

The said Ordinance vide sub-section (9) of section 11C of the SEBI Act, provides that SEBI may make regulations in relation to search and seizure under section 11C of the SEBI Act. A corresponding provision as clause (cc) has also been inserted in sub-section (2) of section 30 of SEBI Act enabling SEBI to frame regulations providing for the procedure to be followed by the authorised officer for search or seizure under sub-section (8) of section 11C of SEBI Act.

In order to exercise the powers of search and seizure at the time of Investigation, harmonious with the rights of the persons who are subjected to search of their person and property, while pursuing the SEBI's statutory mandate of investor protection, detailed procedures relating to the procedural safeguards during different stages of search and seizure and the rights of those persons subjected to search and the obligations of the authorized persons, SEBI placed a draft regulations titled SEBI (Procedure for Search and Seizure) Regulations, 2013 dated 14.11.2013 and invited comments from the public on the draft regulations.

Keeping the above in perspective, SEBI on January 10, 2014 issued the SEBI (Procedure for Search and Seizure) Regulations, 2014, specifying detailed procedures to be followed at different stages of an investigation. The salient features of the Regulation are as under:
Warrant of Authority

The authorized officer by SEBI is the Investigation authority under these regulations given power to cause search and seizure. If the investigation authority believes that any or all of the grounds specified in Section 11C(8) of the Act exist, he may make a request either in writing or in electronic mode in Form A to the Chairman of the SEBI with the request to issue a warrant of authority specifying the grounds and reasons for multiple execution, if required. In the request the details of the person or enterprise and its building, place, vessel, vehicle or aircraft whose search is required to be authorized.

On receipt of the request from the Authority the Chairman may, after being satisfied that it is necessary to do so, authorize the Investigating Authority or any other officer of SEBI as the Authorized Officer by issuing a Warrant of Authority in Form B, duly signed by the Chairman and sealed. The Chairman may authorize multiple execution of the warrant of authority during the period in which it is in force.

Every warrant issued shall remain in force until it is cancelled by the Chairman or until it is executed, or till the expiry of the time limit specified for execution in the warrant of authority, whichever is earlier. A warrant of authority issued to any officer of SEBI shall expire on the date of the order of the transfer of such order. A warrant issued to more than one officer of SEBI, may be executed by all or any one or more of them. The warrant shall be returned to the Chairman after being executed fully along with the seizure memo or if not executed, whether partially or not, within the time authorized, for its execution, on the expiry of such time. The authorized officer shall make an endorsement on the warrant of authority stating as to the powers which have been exercised by him under such authority.

Procedure to search

The following is the procedure in respect of a search:

Relating to witness

- Before making a search, the authorized officer shall call upon two or more independent and respectable inhabitants of the locality in which the place to be searched to situate or any other locality if no such inhabitant of the said locality is availing or is willing to be a witness to the search, to attend and witness the search and may issue an order in writing to them or any of them so to do;
- If the authorized officer finds that no witness is available, he shall execute the warrant of authority on the execution being video graphed and the search shall not be invalid on the mere ground that no one has stood as witness to the search;
- No person witnessing the search shall be compelled to be a witness in any quasi judicial proceedings under the securities laws except as and when summoned by SEBI or the authority before whom such proceedings are pending;
Relating to places and buildings

- It shall be lawful for the authorized officer executing the warrant of authority to enter into such buildings or places, to break open any outer or inner door or window of any building or place, whether that of the person to be searched or any other person, if after notification, be cannot otherwise obtain admittance;
- If such building or place is an apartment in actual occupancy of a woman, the authorized Officer shall before entering such place give notice to such woman that she is at liberty to withdraw and shall afford her every reasonable facility for withdrawing and may then break open any outer or inner door or window of the apartment and enter it;
- The authorized officer may require any person who is the owner or has the immediate possession or control of any box, locker, safe, almirah or any other receptacle situate in such building, place to open the same and allow access to inspect or examine its contents and where the keys are not available or where such person fails to comply with any such requirement, may cause any action to be taken including the breaking open of such box, locker, safe, almirah or other receptacle which the Authorized Officer may deem necessary for carrying out all or any of the purposes specified under the warrant of authority;
- The Authorized Officer may require, pending the commencement of the search, any person not to remove from such building or place any article or other thing;
- The Authorized Officer may require the service of any police officer or of any officer of the Central Government or State Government or all of them to assist him for all or any of the purposes specified in the Warrant of Authority;
- The Authorized Officer may search, with such assistance, any building or place, authorized to be searched, where such information or documents are expected or believed to be kept;

Relating to vessel, vehicle or aircraft

- The Authorized Officer on production of the warrant of authority to the person in charge of vessel, vehicle or aircraft, shall have the free ingress to vessel, vehicle or aircraft for the execution;
- It shall be lawful for the Authorized Officer to require the person for the time being control of the vehicle, vessel or aircraft to stop any such of them from moving; if it is in move compel them to stop;
- The Authorized Officer shall have the authority to break open any outer or inner door or window of any such of them, if after notification of the authority and purpose and demand of admittance duly made, he cannot obtain otherwise;
- If the same is occupied by a woman who according to custom does not appear in public, the Authorized Officer shall, before entering such of them, give notice to such woman that she is at liberty to withdraw and shall afford her every reasonable facility for withdrawing;
- The authorized officer may require any person who is the owner or has the immediate possession or control of any box, locker, safe, almirah or any other receptacle situate in such of them, place to open the same and allow access to inspect or examine its contents and where the keys are not available or where such person fails to comply with any such requirement, may cause any action to be taken including the breaking open of such box,
locker, safe, almirah or other receptacle which the Authorized Officer may deem necessary for carrying out all or any of the purposes specified under the warrant of authority;

- If the same is found unsuitable for the search the Authorized Officer shall require the person in charge to take the same to the place which is considered suitable for the search and require that person to accompany with them;
- The Authorized Officer may require the person in charge of the vessel, vehicle or aircraft not to remove from them any article or other thing, pending the commencement of the search;
- The Authorized Officer may taken the services of the any police officer or any officer of the Central or State Government or all of them to assist him for all or any of the purposes;
- The Authorized officer may search with such assistance the vehicle, vessel or aircraft where such information or documents are expected or believed to be kept.

Search of person

- Any person who has got out of or is about to get into or is in the building, place, vessel, vehicle or aircraft authorized to be searched is suspected that he has secreted any books of account or other documents then the Authorized Officer shall made a search for that person;
- If such a person is a female, the search shall be made by a female officer with strict regard to decency;
- The Authorized Officer may require the services of any police officer or of any officer of the Central or State Government or all of them to assist him in the search.

Search of Computer

- The Authorized Officer, in the process of search may use reasonable measures to access a computer system that the person being searched is carrying or that is in the person’s physical possession or immediate control;
- He may operate any computer or other device or cause any such computer or other devices to be operated by a person accompanying the Authorized Officer; and
- He may require any person to facilitate access, to provide access to the information held in any such computer or other device which can be accessed by the use of that computer or data storage device-
  - To get any password necessary to operate; or
  - Otherwise to enable to examine the information accessible by the computer in a form in which the information is visible and legible.

Power of Inspection

The Authorized Officer if so authorized shall have the power of inspection of the documents found in any place, building, vessel, vehicle and aircraft.
Power of seizure

The Authorized Officer shall have the power to seize any such books of account or other documents found as a result of such search, or get the signature of such persons. If it is not practicable to seize he may serve an order in Form C or Form D on the person who has the owner or having the control, part with or otherwise deal with it except with the previous permission of the Authorized Officer and such person shall thereupon take such steps as may be necessary for ensuring compliance with the order.

Seizure Memo

In the seizure process the Authorized Officer may prepare a seizure memo in the prescribed Form signed by two witnesses, containing a list of all documents seized or copied in the course of such search and of the place in which they were respectively found and verify the inventory of any such documents seized. In seizing the electronic storage media he shall enter in Form F the description of the physical storage media that were seized or copied. The seizure memo shall contain the following details-

- The time of entry into and exit from place, building, vessel, vehicle or aircraft;
- The identity of the persons searched;
- The address of place and building and details of vessel, vehicle or aircraft searched;
- The details of officers present, if any, at the time of seizure;
- The details of other persons present, if any, at the time of seizure;
- The signature of the authorized officer;
- The signature of the witnesses with thump impression and date;
- The description of identification mark, if any, placed by any person from whose possession or control the documents are seized;
- The signature of the owner or the person who is in immediate possession or control of premises, building, vehicle or aircraft, if available therein;
- The signature of the person from whom the seizure is effected.

Powers of Authorized Officer

The following are the powers of the Authorized Officer-

- To place identification mark on any books of account or other documents;
- To make or cause to be made extracts or copy of documents of any books of account;
- To record on oath the statement of any person in the presence of two witnesses.

Obligations of the Authorized Officer

The Authorized Officer, before executing the warrant of Authority shall-

- Identify himself either by name or by official identification documents;
• Show the warrant of authority to the person concerned;
• Conduct search and seizure in the presence of the witnesses and prepare panchnama as prescribed in Form G;
• Deliver a copy of the seizure memo to any person from whose possession or control the documents are seized;
• Not enter at any place of business or profession after day time;
• Execute the warrant of authority within the time limit prescribed, if any, in the warrant of authority.

Rights of persons under search and persons in charge

The following are the rights of the persons under search and persons in charge-

• To see the warrant of authority and authorized officer and to obtain a copy thereof;
• To verify the identity of the authorized officer and officials assisting him;
• To be present during the search and seizure;
• To put his own mark of identification on the documents seized along with his signature, stamp, seal, etc.;
• To have copy of document seized or take extracts in the presence of Authorized Officer;
• To have a copy of any statement recorded during search and seizure.

Obligations of persons under search and persons in charge

The following are the obligations on the part of the persons under search and persons in charge-

• Any person in charge of any building, place shall identify any person as may be required;
• Any person in charge of vessel, vehicle or aircraft on demand locate and identify the vessel, vehicle or aircraft;
• Allow the Authorized Officer free ingress and afford all reasonable facilities for a search;
• Stop the vessel or vehicle or stop and cause to be landed any aircraft on communication of the Authorized Officer;
• Bound to disclose the password and such other information in case of computer devices;
• Provide necessary facility to inspect books of account or other documents;
• Identify the locker etc., and to hand over keys of the same to the Authorized Officer;
• No officer shall be prevented from execution of Warrant of Authority.

Safe Custody of seized documents

The seized documents shall be transmitted in safe manner to the place of custody. The Authorized Officer shall hand over the documents seized along with the seizure memo to the Investigating Authority, who shall keep the same in his custody for such period not later than the conclusion of the investigation as he considers necessary. The same shall not be retained more than 180 days from the date of seizure except with the approval of the Chairman. It shall be ensured that records in physical form are not altered, damaged, mutilated and the records in electronic form is not
altered or erased. It is also ensured that the seized articles are stored, maintained in suitable physical and environmental conditions.

Return of documents

The Investigating Authority shall return the documents to the person from whom the same were seized. Before returning such documents identification marks are to be recorded. Any person information severable from any documents shall be returned to the person to whom such information relates on a written request being made in this behalf by him.

Protection of Personal Information

The personal information contained in any document seized shall not be divulged to any third person except for the compliance of any law for the time being in force, without the consent of the person to whom the information relates.

Retention of forensic copy

The forensic copy of the data or mirror image of the storage device and any copy thereof may be retained, on being satisfied that such data or image has evidentiary value. Any copy made or generated from any other document may be retained.

Liability for non compliance of obligations

Any intermediary who fails to comply with any of the obligations shall be liable for any one or more of the following actions-

- Adjudication under Section 15HB of SEBI Act;
- Proceedings under chapter V of SEBI (Intermediaries) Regulations, 2008;
- Prosecution under Section 24 of the Act.

Any person other than an intermediary who fails to comply with any of the obligations shall be liable for any one or more of the following actions-

- Adjudication under Section 15HB of SEBI Act;
- Action under Section 11B and Section 11(4) of the Act;
- Prosecution under Section 24 of the Act.
Lesson 16
Listing and Delisting of Securities

CORPORATE GOVERNANCE THROUGH LISTING AGREEMENT

Corporate governance denotes the process, structure and relationship through which the Board of Directors oversees what the management does. It is also about being answerable to different stakeholders.

CII constituted a Committee to recommend a Code of Corporate Governance to be observed by corporates in their functioning. The Committee further recommended a Code popularly known as "Desirable Corporate Governance Code" which defined Corporate Governance as follows:

“Corporate governance deals with laws, procedures, practices and implicit rules that determine a company’s ability to take informed managerial decisions vis-à-vis its claimants – in particular, its shareholders, creditors, customers, the State and employees. There is a global consensus about the objective of ‘good’ corporate governance: maximising long-term shareholder value.”

The Kumar Mangalam Birla Committee Constituted by SEBI has observed that:

“Strong corporate governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high-quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure.”

N.R. Narayana Murthy Committee on Corporate Governance constituted by SEBI has observed that:

“Corporate Governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company.”

The Institute of Company Secretaries of India has also defined the term Corporate Governance as under:

Good Governance in capital market has always been high on the agenda of SEBI. Corporate Governance is looked upon as a distinctive brand and benchmark in the profile of Corporate Excellence. This is evident from the continuous updation of guidelines, rules and regulations by SEBI for ensuring transparency and accountability. In the process, SEBI had constituted a Committee on Corporate Governance under the Chairmanship of Shri Kumar Mangalam Birla. The Committee in its report observed that “the strong Corporate Governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure.”

Based on the recommendations of the Committee, the SEBI had specified principles of Corporate Governance and introduced a new clause 49 in the Listing agreement of the Stock Exchanges in the year 2000. These principles of Corporate Governance were made applicable in a phased manner and all the listed companies with the paid up capital of Rs 3 crores and above or net worth of Rs 25 crores or more at any time in the history of the company, were covered as of March 31, 2003.

SEBI, as part of its endeavour to improve the standards of corporate governance in line with the needs of a dynamic market, constituted another Committee on Corporate Governance under the Chairmanship of Shri N. R. Narayana Murthy to review the performance of Corporate Governance and to determine the role of companies in responding to rumour and other price sensitive information circulating in the market in order to enhance the transparency and integrity of the market. The Committee in its Report observed that “the effectiveness of a system of Corporate Governance cannot be legislated by law, nor can any system of Corporate Governance be static. In a dynamic environment, system of Corporate Governance need to be continually evolved.”

With a view to promote and raise the standards of Corporate Governance, SEBI on the basis of recommendations of the Committee and public comments received on the report and in exercise of powers conferred by Section
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SEBI vide circular number SEBI/CFD/ DIL/CG/1/2004/12/10 dated October 29, 2004 again revised the existing Clause 49 of the Listing Agreement directing all the Stock Exchanges to amend the Listing Agreement by replacing the existing Clause 49 of the Listing Agreement. As per the Circular, the provisions of the Clause 49 were to be implemented as per the schedule of implementation given below:

(a) For entities seeking listing for the first time, at the time of seeking in-principle approval for such listing.

(b) For existing listed entities which were required to comply with Clause 49 which is being revised i.e. those having a paid up share capital of Rs. 3 crores and above or net worth of Rs. 25 crores or more at any time in the history of the company, by April 1, 2005.

However noticing that large number of companies were not in the state of preparedness to be fully compliant with the requirements of revised Clause 49 of the listing agreement, SEBI allowed more time to corporates to conform to Clause 49 of the listing agreement and extended the date for ensuring compliance with the Clause 49 of the listing agreement to December 31, 2005.

The Companies Act, 2013 was enacted on August 30, 2013 which provides for a major overhaul in the Corporate Governance norms for all companies. The rules pertaining to Corporate Governance were notified on March 27, 2014. The requirements under the Companies Act, 2013 and the rules notified there under would be applicable for every company or a class of companies (both listed and unlisted) as may be provided therein. SEBI reviewed the provisions of the Listing Agreement in this regard with the objectives to align with the provisions of the Companies Act, 2013, adopt best practices on corporate governance and to make the corporate governance framework more effective.

SEBI vide its circular dated April 17, 2014, revised new clause 49 in alignment with Companies Act, 2013.

The revised Clause 49 would be applicable to all listed companies with effect from October 01, 2014. However, the provisions of Clause 49(VI)(C) as given in Part-B shall be applicable to top 100 listed companies by market capitalisation as at the end of the immediate previous financial year.

For other listed entities which are not companies, but body corporate or are subject to regulations under other statutes (e.g. banks, financial institutions, insurance companies etc.), the Clause 49 will apply to the extent that it does not violate their respective statutes and guidelines or directives issued by the relevant regulatory authorities. **The Clause 49 is not applicable to Mutual Funds.**

**HIGHLIGHTS OF CLAUSE 49**

**COMPOSITION OF BOARD OF DIRECTORS**

As per clause 49 (II) (A) of the Listing Agreement, the Board of Directors of the company shall have an optimum combination of executive and non executive directors with atleast one women director. Further—

- not less than 50 per cent of the board of directors shall comprise of non-executive directors;
- the number of independent directors would depend on whether the chairman is executive or non-executive;
- if the Board has a Non-Executive Chairman, at least one third of the Board should comprise of independent directors;
- if the Board has an Executive Chairman, at least half of the Board should comprise of independent directors.
If the non-executive Chairman is a promoter or is related to promoters or persons occupying management positions at the board level or at one level below the board, at least one-half of the board of the company should consist of independent directors. The expression “related to any promoter” means:

(a) If the promoter is a listed entity, its directors other than the independent directors, its employees or its nominees shall be deemed to be related to it;

(b) If the promoter is an unlisted entity, its directors, its employees or its nominees shall be deemed to be related to it.

Definition of Independent Director

(i) Under Listing agreement

'Independent director' shall mean a non-executive director, other than a nominee director of the company:

(a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

(b) (i) who is or was not a promoter of the company or its holding, subsidiary or associate company;

(ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

(c) apart from receiving director's remuneration, has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

(d) none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

(e) who, neither himself nor any of his relatives –

(i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

(ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of –

(A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

(B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent or more of the gross turnover of such firm;

(iii) holds together with his relatives two per cent or more of the total voting power of the company; or

(iv) is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives twenty-five per cent or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent or more of the total voting power of the company;

(v) is a material supplier, service provider or customer or a lessor or lessee of the company;

(f) who is not less than 21 years of age.
(ii) Under Companies Act, 2013

According to Section 149(6) of the Companies Act, 2013 – An independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director, – (a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience; (b) (i) who is or was not a promoter of the company or its holding, subsidiary or associate company; (ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company; (c) who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year; (d) none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year; (e) who, neither himself nor any of his relatives (i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed; (ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of (A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or (B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm; (iii) holds together with his relatives two per cent. or more of the total voting power of the company; or (iv) is a Chief Executive or director, by whatever name called, of any nonprofit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or (f) who possesses such other qualifications as may be prescribed.

Limit on number of directorships

(a) A person shall not serve as an independent director in more than seven listed companies.

(b) Further, any person who is serving as a whole time director in any listed company shall serve as an independent director in not more than three listed companies.

Maximum tenure of Independent Directors

(a) An independent director shall hold office for a term up to five consecutive years on the Board of a company and shall be eligible for reappointment for another term of up to five consecutive years on passing of a special resolution by the company.

Provided that a person who has already served as an independent director for five years or more in a company as on October 1, 2014 shall be eligible for appointment, on completion of his present term, for one more term of up to five years only.

Provided further that an independent director, who completes his above mentioned term shall be eligible for appointment as independent director in the company only after the expiration of three years of ceasing to be an independent director in the company.

Formal letter of appointment to Independent Directors

(a) The company shall issue a formal letter of appointment to independent directors in the manner as provided in the Companies Act, 2013.

(b) The letter of appointment along with the detailed profile of independent director shall be disclosed on the websites of the company and the Stock Exchanges not later than one working day from the date of such appointment.
Performance evaluation of Independent Directors

(a) The Nomination Committee shall lay down the evaluation criteria for performance evaluation of independent directors.

(b) The company shall disclose the criteria for performance evaluation, as laid down by the Nomination Committee, in its Annual Report.

(c) The performance evaluation of independent directors shall be done by the entire Board of Directors (excluding the director being evaluated).

(d) On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.

Separate meetings of the Independent Directors

(a) The independent directors of the company shall hold at least one meeting in a year, without the attendance of non-independent directors and members of management. All the independent directors of the company shall strive to be present at such meeting.

(b) The independent directors in the meeting shall, *inter-alia*:

   (i) review the performance of non-independent directors and the Board as a whole;

   (ii) review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;

   (iii) assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

Training of Independent Directors

(a) The company shall provide suitable training to independent directors to familiarize them with the company, their roles, rights, responsibilities in the company, nature of the industry in which the company operates, business model of the company, etc.

(b) The details of such training imparted shall be disclosed in the Annual Report.

An independent director who resigns or is removed from the Board of the Company shall be replaced by a new independent director within a period of not more than 180 days from the day of such resignation or removal, as the case may be. However, if the company fulfills the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director within the period of 180 days would not apply.

Non Executive Directors’ Compensation and Disclosures

This clause provides that all fees/compensation, if any paid to non-executive directors, including independent directors, shall be fixed by the Board of Directors and require previous approval of shareholders in general meeting. The shareholders' resolution shall specify the limits for the number of stock options that can be granted to non-executive directors in any financial year and in aggregate. The requirement of obtaining prior approval of shareholder in general meeting shall not apply to payment of sitting fees to non-executive directors, if made within the limits prescribed under the Companies Act 2013 for payment of sitting fees, without approval of the Central Government. Further, the independent directors shall not be entitled to any stock option.

BOARD MEETINGS

The Board shall meet at least four times a year with a maximum time gap one hundred and twenty days between any two meetings.
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Limits on Membership of Committees

A director shall not be a member in more than 10 committees or act as chairman of more than five committee across all companies in which he is a director. Furthermore, every director shall inform the company about the committees positions he occupies in other companies and notify changes as and when takes place.

For the purpose of considering the limit of committees on which a director can serve, all public limited companies, whether listed or not listed, shall be included and all other companies including private limited companies, foreign companies and companies under section 8 of the Companies Act, 2013 shall be excluded.

For the purpose of considering the limit of the committees on which a director can serve, Chairmanship/ membership of the Audit Committee and the Share-holders' Grievance Committee alone are to be considered.

Other provisions as to Board and Committees

The Board shall periodically review compliance reports of all laws applicable to the company, prepared by the company as well as steps taken by the company to rectify instances of non-compliances.

An independent director who resigns or is removed from the Board of the Company shall be replaced by a new independent director at the earliest but not later than the immediate next Board meeting or three months from the date of such vacancy, whichever is later. Provided that where the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director shall not apply.

The Board of the company shall satisfy itself that plans are in place for orderly succession for appointments to the Board and to senior management.

Code of Conduct

1. The Board shall lay down a code of conduct for all Board members and senior management of the company. The code of conduct shall be posted on the website of the company.

2. All Board members and senior management personnel shall affirm compliance with the code on an annual basis. The Annual Report of the company shall contain a declaration to this effect signed by the CEO.

3. The Code of Conduct shall suitably incorporate the duties of Independent Directors as laid down in the Companies Act, 2013.

4. An independent director shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently with respect of the provisions contained in the Listing Agreement.

Explanation: The term “senior management” shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.

Whistle Blower Policy

1. The company shall establish a vigil mechanism for directors and employees to report concerns about unethical behaviour, actual or suspected fraud or violation of the company’s code of conduct or ethics policy.

2. This mechanism should also provide for adequate safeguards against victimization of director(s) / employee(s) who avail of the mechanism and also provide for direct access to the Chairman of the Audit Committee in exceptional cases.

3. The details of establishment of such mechanism shall be disclosed by the company on its website and in the Board’s report.
Clause 49(III) deals with Audit Committee, its composition, power etc.

(i) The requirement of giving terms of reference of the Audit Committee is a must.

(ii) There should be minimum three directors as members.

(iii) 2/3rd of the members of audit committee shall be independent directors.

(iv) All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

Explanation: (a) The term “financially literate” means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

(b) A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual’s financial sophistication, including being or having been a chief executive officer, chief financial officer, or other senior officer with financial oversight responsibilities.

(v) The Chairman of the audit committee shall be an independent director and shall be present at the Annual General Meeting to answer shareholder queries.

(vi) The audit committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee.

(vii) The company secretary should act as the secretary to the committee.

Powers of the Audit Committee

The powers of the Audit Committee shall include the following:

(i) To investigate any activity within its terms of reference.

(ii) To seek information from any employee.

(iii) To obtain outside legal or other professional advice.

(iv) To secure attendance of outsiders with relevant expertise, if it considers necessary.

Meetings and Role of Audit Committee

There is requirement of holding atleast four meetings in a year and not more than four months shall elapse between the two meetings of audit committee. Quorum of the meeting shall be two member or 1/3rd of members of the Audit Committee whichever is greater, but there should be a minimum of two independent members present.

The role of the audit committee shall include the following:

1. Oversight of the company’s financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.

2. Recommending for appointment, remuneration and terms of appointment of auditors of the company.

3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors.
4. Reviewing, with the management, the annual financial statements before submission to the board for approval, with particular reference to:
   (a) Matters required to be included in the Director’s Responsibility Statement to be included in the Board’s report in terms of clause (c) of section 134 of the Companies Act, 2013.
   (b) Changes, if any, in accounting policies and practices and reasons for the same.
   (c) Major accounting entries involving estimates based on the exercise of judgment by management.
   (d) Significant adjustments made in the financial statements arising out of audit findings.
   (e) Compliance with listing and other legal requirements relating to financial statements.
   (f) Disclosure of any related party transactions.
   (g) Qualifications in the draft audit report.

5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval.

6. Reviewing, with the management, the statement of uses/application of fund raised through an issue (public issue, right issue, preferential issue, etc.), the statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and the report submitted by the monitoring agency monitoring the utilization of proceeds of a public or rights issue, and making appropriate recommendations to the Board to take steps in this matter.

7. Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems.

8. Review and monitor the auditor’s independence and performance and effectiveness of audit process.

9. Approval of any subsequent modification of transaction of the company with related parties;

10. Scrutiny of inter-corporate loans and investment.

11. Valuation of undertaking or assets of the company, wherever it is necessary.

12. Evaluation of internal financial control and risk management systems.

13. Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.

14. Discussion with internal auditors any significant findings and follow up there on.

15. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.

16. Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.

17. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.

18. To review the functioning of the Whistle Blower mechanism, in case the same is existing.

19. Approval of appointment of CFO (i.e. the whole-time finance Director or any other person heading the finance function or discharging that function) after assessing the qualification, experience and back of mind, etc. of the candidate.
20. Carrying out any other function as is mentioned in the terms of reference of the Audit Committee

**Review of Information by Audit Committee**

The Audit Committee is required to mandatorily review the following information:

(a) Management discussion and analysis of financial condition and results of operations;
(b) Statement of significant related party transactions (as defined by the audit committee), submitted by the management;
(c) Management letters/letters of internal control weaknesses issued by statutory auditors;
(d) Internal audit reports relating to internal control weaknesses; and
(e) The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee.

**Nomination and Remuneration Committee**

A. The company shall set up a nomination and remuneration committee which shall comprise at least three directors, all of whom shall be non-executive directors and at least half shall be independent. Chairman of the committee shall be an independent director.

B. The role of the committee shall, *inter-alia*, include the following:

1. Formulation of the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration of the directors, key managerial personnel and other employees;
2. Formulation of criteria for evaluation of Independent Directors and the Board;
3. Devising a policy on Board diversity;
4. Identifying persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend to the Board their appointment and removal. The company shall disclose the remuneration policy and the evaluation criteria in its Annual Report.

C. The Chairman of the nomination and remuneration committee could be present at the Annual General Meeting, to answer the shareholders' queries. However, it would be up to the Chairman to decide who should answer the queries.

**SUBSIDIARY COMPANY**

(i) At least one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of material non-listed Indian subsidiary company.
(ii) The Audit Committee of the listed holding company shall also review the financial statements, in particular the investments made by the unlisted subsidiary company.
(iii) The minutes of the Board meetings of the unlisted subsidiary company is required to be placed at the Board meeting of the listed holding company.
(iv) The management should periodically bring to the attention of the Board of Directors of the listed holding company, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary company.
(v) The company shall formulate a policy for determining 'material' subsidiaries and such policy shall be disclosed to Stock Exchanges and in the Annual Report.
(vi) For the purpose of this clause, a subsidiary shall be considered as material if the investment of the company in the subsidiary exceeds twenty per cent of its consolidated net worth as per the audited balance sheet of the previous financial year or if the subsidiary has generated twenty per cent of the consolidated income of the company during the previous financial year.

(vii) No company shall dispose of shares in its material subsidiary which would reduce its shareholding (either on its own or together with other subsidiaries) to less than 50% or cease the exercise of control over the subsidiary without passing a special resolution in its General Meeting.

(viii) Selling, disposing and leasing of assets amounting to more than twenty percent of the assets of the material subsidiary shall require prior approval of shareholders by way of special resolution.

The term “material non-listed Indian subsidiary” means an unlisted subsidiary, incorporated in India, whose turnover or net worth (i.e. paid up capital and free reserves) exceeds 20% of the consolidated turnover or net worth respectively, of the listed holding company and its subsidiaries in the immediately preceding accounting year.

The term “significant transaction or arrangement” means any individual transaction or arrangement that exceeds or is likely to exceed 10% of the total revenues or total expenses or total assets or total liabilities, as the case may be, of the material unlisted subsidiary for the immediately preceding accounting year.

Where a listed holding company has a listed subsidiary which is itself a holding company, the above provisions also apply to the listed subsidiary insofar as its subsidiaries are concerned.

**Risk Management**

A. The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures.

B. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the company.

C. The company shall also constitute a Risk Management Committee. The Board shall define the roles and responsibilities of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit.

**Related Party Transactions**

A. A related party transaction is a transfer of resources, services or obligations between a company and a related party, regardless of whether a price is charged.

B. A ‘related party’ is a person or entity that is related to the company. Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party, directly or indirectly, in making financial and/or operating decisions and includes the following:

1. A person or a close member of that person’s family is related to a company if that person:
   a. is a related party under Section 2(76) of the Companies Act, 2013; or
   b. has control or joint control or significant influence over the company; or
   c. is a key management personnel of the company or of a parent of the company; or

2. An entity is related to a company if any of the following conditions applies:
   a. The entity is a related party under Section 2(76) of the Companies Act, 2013; or
   b. The entity and the company are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others); or
c. One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member); or

d. Both entities are joint ventures of the same third party; or

e. One entity is a joint venture of a third entity and the other entity is an associate of the third entity; or

f. The entity is a post-employment benefit plan for the benefit of employees of either the company or an entity related to the company. If the company is itself such a plan, the sponsoring employers are also related to the company; or

g. The entity is controlled or jointly controlled by a person identified in (1).

h. A person identified in (1)(b) has significant influence over the entity (or of a parent of the entity); or

DISCLOSURES

The following disclosures are required to be made under the revised clause:

– Related Party Transactions
– Disclosure of Accounting Treatment
– Remuneration of Directors
– Management
– Shareholders
– Resignation of Directors
– Formal letters of appointment
– Annual Report
– Proceeds from public issues, Rights issues, preferential issues etc.

CEO/CFO CERTIFICATION

Clause 49(IX) deals with the CEO/CFO certification

The CEO, i.e. the Managing Director or Manager appointed in terms of the Companies Act, 1956 and Companies Act 2013 and the CFO i.e. the whole-time Finance Director or any other person heading the finance function discharging that function shall certify to the Board that:

(a) They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief :

   (i) these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;

   (ii) these statements together present a true and fair view of the company’s affairs and are in compliance with existing accounting standards, applicable laws and regulations.

(b) There are, to the best of their knowledge and belief, no transactions entered into by the company during the year which are fraudulent, illegal or violative of the company’s code of conduct.

(c) They accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of the internal control systems of the company pertaining to financial reporting and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of such internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.
(d) They have indicated to the auditors and the Audit committee –

(i) significant changes in internal control over financial reporting during the year;

(ii) significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and

(iii) instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company’s internal control system over financial reporting.

**REPORT ON CORPORATE GOVERNANCE**

Clause 49(X) narrates the details with respect to Corporate Governance.

The companies shall submit a quarterly compliance report to the stock exchanges within 15 days from the close of quarter as per the format prescribed in this clause. The report is required to be signed either by the Compliance Officer or the Chief Executive Officer of the company. In annual report there should be a separate section on corporate governance and should contain the details as given in listing agreement.

**COMPLIANCE CERTIFICATE**

Clause 49(XI) deals with compliance certificate on Corporate Governance.

The practising Company Secretaries have also been recognised to issue Certificate of Compliance of Conditions of Corporate Governance. The clause provides that the company shall obtain a certificate from either the auditors or practicing company secretaries regarding compliance of conditions of corporate governance as stipulated in this clause and annex the certificate with the directors’ report, which is sent annually to all the shareholders of the company. The same certificate shall also be sent to the Stock Exchanges along with the annual report filed by the company.

**NON MANDATORY REQUIREMENTS**

The following non-mandatory requirements have additionally been provided:

(1) **The Board**

A non-executive Chairman may be entitled to maintain a Chairman’s office at the company’s expense and also allowed reimbursement of expenses incurred in performance of his duties.

(2) **Shareholder Rights**

A half-yearly declaration of financial performance including summary of the significant events in last six-months, may be sent to each household of share-holders.

(3) **Audit qualifications**

Company may move towards a regime of unqualified financial statements.

(4) **Separate posts of Chairman and CEO**

The Company may appoint separate persons to the post of chairman and Managing Director/CEO.

(5) **Reporting of Internal Auditor**

The internal auditor may report directly to the Audit Committee.
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<td>Partition of Nominee Director and IDs</td>
<td>Clause 49(II)(B): Nominee director is excluded from the definition of IDs.</td>
<td>Section 149(6) An independent director in relation to a company, means a director other than a MD or a WTD or a nominee director.</td>
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<td>2.</td>
<td>Modified definition of IDs</td>
<td>Clause 49(II)(B): SEBI has amended the definition of Independent Director in alignment with the provisions of Companies Act, 2013.</td>
<td>Section 149(6) of the Companies Act 2013 defines the term Independent Director.</td>
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<tr>
<td>3.</td>
<td>Qualification of IDs</td>
<td>The qualifications of IDs are not specified in the amended clause 49 of the listing agreement</td>
<td>Companies (Appointment and Qualification of Directors) Rules, 2014: An independent director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company’s business.</td>
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<td>4.</td>
<td>Whistle-Blowing Mechanism</td>
<td>Clause 49(II)(F): The company shall establish a vigil mechanism for directors and employees to report concerns about unethical behaviour, actual or suspected fraud or violation of the company’s code of conduct or ethics policy. This mechanism should also provide for adequate safeguards against victimization of director(s)/employee(s) who avail of the mechanism and also provide for direct access to the Chairman of the Audit Committee in exceptional cases. The details of establishment of such mechanism shall be disclosed by</td>
<td>Section 177(9): Every listed company and other classes of companies to establish a Vigil mechanism for directors and employees to report genuine concern. It provide adequate safeguards against victimization of employees and directors who avail of the Vigil mechanism and also provide for direct access to the chairperson of the Audit committee or the director nominated to play the role of audit committee, as the case may be, in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organization. The details of establishment of Vigil mechanism</td>
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<tr>
<td><strong>Lesson 16</strong></td>
<td><strong>Listing and Delisting of Securities</strong></td>
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<td>5.</td>
<td><strong>Prohibited Stock options for IDs</strong></td>
<td><strong>Clause 49(II)(C)</strong>: IDs shall not be entitled to any stock options.</td>
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<td><strong>Section 197(7)</strong>: IDs shall not entitled to any stock option.</td>
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<td>6.</td>
<td><strong>Separate meeting of IDs</strong></td>
<td><strong>Clause 49(II)(B)(6)</strong>: The IDs of the company shall hold at least one meeting in a year, without the attendance of non independent directors and members of management. All the independent directors of the company shall strive to be present at such meeting.</td>
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<td></td>
<td><strong>Section 149 read with Schedule IV</strong>: IDs of the company shall hold at least one meeting in a year, without the attendance of non independent directors and members of management. All the independent directors of the company shall strive to be present at such meeting.</td>
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<td>7.</td>
<td><strong>Training of IDs</strong></td>
<td><strong>Clause 49(II)(B)</strong>: The company shall provide suitable training to independent directors to familiarize them with the company, their roles, rights, responsibilities in the company, nature of the industry in which the company operates, business model of the company, etc. The details of such training imparted shall be disclosed in the Annual Report.</td>
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<td></td>
<td>The Companies Act 2013 did not specify any training of IDs and Board of Directors.</td>
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<td>8.</td>
<td><strong>Liability of IDs</strong></td>
<td><strong>Clause 49(II)(E)</strong>: An independent director shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently with respect of the provisions contained in the Listing Agreement.</td>
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<td><strong>Section 149(12)</strong>: An independent director; a NED not being promoter or KMP, shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.</td>
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<td>9.</td>
<td><strong>Stakeholders Relationship Committee</strong></td>
<td><strong>Clause 49(VIII)(E)</strong>: A committee under the Chairmanship of a non-executive director and such other members as</td>
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|   |   | **Section- 178(5)**: The Board of Directors of a company which consists of more than one thousand shareholders,
may be decided by the Board of the company shall be formed to specifically look into the redressal of grievances of shareholders, debenture holders and other security holders. This Committee shall be designated as ‘Stakeholders Relationship Committee’ and shall consider and resolve the grievances of the security holders of the company including complaints related to transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends.

1. All pecuniary relationship or transactions of the non-executive directors vis-a-vis the company shall be disclosed in the Annual Report. 
2. In addition to the disclosures required under the Companies Act, 2013, the following disclosures on the remuneration of directors shall be made in the section on the corporate governance of the Annual Report: 
   (a) All elements of remuneration package of individual directors summarized under major groups, such as salary, benefits, bonuses, stock options, pension etc. 
   (b) Details of fixed component and performance linked incentives, along with the performance criteria. 
   (c) Service contracts, notice period, severance fees. 
   (d) Stock option details, if any – and whether issued at a discount as well as the period over which accrued and over which exercisable. 
3. The company shall publish its Section 197 (2) and Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014: 
   (1) Every listed company shall disclose in the Board’s report: 
      (i) the ratio of the remuneration of each director to the median remuneration of the employees of the company for the financial year. 
      (ii) the percentage increase in remuneration of each director, CFO, CEO, CS or Manager, if any, in the financial year; 
      (iii) the percentage increase in the median remuneration of employees in the financial year; 
      (iv) the number of permanent employees on the rolls of company; 
      (v) the explanation on the relationship between average increase in remuneration and company performance; 
      (vi) comparison of the remuneration of the KMP against the performance of the company; |
criteria of making payments to non-executive directors in its annual report. Alternatively, this may be put up on the company’s website and reference drawn thereto in the annual report.

4. The company shall disclose the number of shares and convertible instruments held by non-executive directors in the annual report.

5. Non-executive directors shall be required to disclose their shareholding (both own or held by/for other persons on a beneficial basis) in the listed company in which they are proposed to be appointed as directors, prior to their appointment.

These details should be disclosed in the notice to the general meeting called for appointment of such director.

(vii) variations in the market capitalisation of the company, price earnings ratio as at the closing date of the current financial year and previous financial year and percentage increase over decrease in the market quotations of the shares of the company in comparison to the rate at which the company came out with the last public offer in case of listed companies, and in case of unlisted companies, the variations in the net worth of the company as at the close of the current financial year and previous financial year;

(viii) average percentile increase already made in the salaries of employees other than the managerial personnel in the last financial year and its comparison with the percentile increase in the managerial remuneration and justification thereof and point out if there are any exceptional circumstances for increase in the managerial remuneration;

(ix) the key parameters for any variable component of remuneration availed by the directors;

(x) the ratio of the remuneration of the highest paid director to that of the employees who are not directors but receive remuneration in excess of the highest paid director during the year; and

(xi) affirmation that the remuneration is as per the remuneration policy of the company.
<table>
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<tr>
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<th>Performance evaluation of IDs</th>
<th>Clause 49(II)(B)(5):</th>
<th>Section 178(2) read with Schedule IV:</th>
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<td>(a) The Nomination Committee shall lay down the evaluation criteria for performance evaluation of independent directors.</td>
<td>The Nomination and Remuneration Committee shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal and shall carry out evaluation of every director’s performance.</td>
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<td>(b) The company shall disclose the criteria for performance evaluation, as laid down by the Nomination Committee, in its Annual Report.</td>
<td>The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated. On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.</td>
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<td>(c) The performance evaluation of independent directors shall be done by the entire Board of Directors (excluding the director being evaluated).</td>
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<td>(d) On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.</td>
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<td>Related Party Transaction (RPT)</td>
<td>Clause 49 (VII):</td>
<td>Section 2 (76) &amp; 188</td>
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<td>A RPT is a transfer of services or obligations between a company and a related party, regardless of whether a price is charged.</td>
<td>&quot;Related party&quot;, with reference to a company, means –</td>
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<td>A ‘related party’ is a person or entity that is related to the company.</td>
<td>(i) a director or his relative</td>
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<td>Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party, directly or indirectly, in making financial and/or operating decisions and includes the following:</td>
<td>(ii) a KMP or his relative;</td>
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<td>1. A person or a close member of that person’s family is related to a company if that person:</td>
<td>(iii) a firm, in which a director, manager or his relative is a partner;</td>
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<td>(a) is a related party under Section 2(76) of the Companies Act, 2013; or</td>
<td>(iv) a private company in which a director or manager is a member or director;</td>
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<td>(b) has control or joint control or significant influence over the company; or</td>
<td>(v) a public company in which a director or manager is a director or holds along with his relatives, more than 2% of its paid-up share capital;</td>
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<td>(vi) any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, or instructions of a director or manager;</td>
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</table>
2. An entity is related to a company if any of the following conditions applies:

(a) The entity is a related party under Section 2(76) of the Companies Act, 2013; or

(b) The entity and the company are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others); or

(c) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member); or

(d) Both entities are joint ventures of the same third party; or

(e) One entity is a joint venture of a third entity and the other entity is an associate of the third entity; or

(f) The entity is a post employment benefit plan for the benefit of employees of either the company or an entity related to the company. If the company is itself such a plan, the sponsoring employers are also related to the company; or

(g) The entity is controlled or jointly controlled by a person identified in (1).
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<td>(h) A person identified in (1)(b) has significant influence over the entity (or of a parent of the entity); or</td>
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<td>The company shall formulate a policy on materiality of RPTs and also on dealing with RPTs. A transaction with a related party shall be considered material if the transaction/transactions to be entered into individually or taken together with previous transactions during a financial year;</td>
<td>Net Worth.</td>
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<td>• exceeds 5% of the annual turnover or</td>
<td>• leasing of property of any kind exceeding 10% of the net worth or exceeding 10% of turnover.</td>
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<td>• 20% of the net worth of the company as per the last audited financial statements of the company, whichever is higher.</td>
<td>• availing or rendering of any services directly or through appointment of agents exceeding 10% of Net Worth.</td>
</tr>
<tr>
<td>All RPTs shall require prior approval of the Audit Committee. All material RPTs shall require approval of the shareholders through special resolution and the related parties shall abstain from voting on such resolutions.</td>
<td>• appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding Rs.2,50,000/- remuneration for underwriting the subscription of any securities or derivatives thereof of the company exceeding 1% of the net worth.</td>
</tr>
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<td>Turnover or Net Worth shall be on the basis of the Audited Financial statements of the preceding Financial Year.</td>
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<td>In case of wholly owned subsidiary, the special resolution passed by the holding company shall be sufficient for the purpose of entering into the transactions between wholly owned subsidiary and holding company.</td>
<td>In case of wholly owned subsidiary, the special resolution passed by the holding company shall be sufficient for the purpose of entering into the transactions between wholly owned subsidiary and holding company.</td>
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<td>No member of the company shall vote on such special resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party:</td>
<td>No member of the company shall vote on such special resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party:</td>
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<td>Where any director is interested in any contract or arrangement with a related party, such director shall not be present at the meeting during discussions on the subject matter of the resolution relating to such contract or arrangement.</td>
<td>Where any director is interested in any contract or arrangement with a related party, such director shall not be present at the meeting during discussions on the subject matter of the resolution relating to such contract or arrangement.</td>
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<td>Every contract or arrangement entered into, shall be referred to in the Board’s report to the shareholders along with the justification for entering into such contract or arrangement.</td>
<td>Every contract or arrangement entered into, shall be referred to in the Board’s report to the shareholders along with the justification for entering into such contract or arrangement.</td>
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<tr>
<td><strong>Lesson 16</strong></td>
<td><strong>Listing and Delisting of Securities</strong></td>
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<tr>
<td>13. <strong>Disclosure of RPTs</strong></td>
<td><strong>Clause 49(VIII)(A):</strong> Details of all material transactions with related parties shall be disclosed quarterly along with the compliance report on corporate governance. The company shall disclose the policy on dealing with RPTs on its website and also in the Annual Report.</td>
</tr>
<tr>
<td>14. <strong>Disclosure of Different Accounting Standard</strong></td>
<td><strong>Clause 49(VIII)(B):</strong> Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management's explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction in the Corporate Governance Report.</td>
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<tr>
<td>15. <strong>Constitution of Nomination &amp; Remuneration Committee</strong></td>
<td><strong>Clause 49(IV)-</strong> The company shall set up a nomination and remuneration committee which shall comprise</td>
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</table>
at least 3 directors, all of whom shall be NEDs and at least ½ shall be independent.

A. Chairman of the committee shall be an independent director.

B. The role of the committee shall, inter-alia, include the following:

1. Formulation of the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration of the directors, KMP and other employees;

2. Formulation of criteria for evaluation of IDs and the Board;

3. Devising a policy on Board diversity;

4. Identifying persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend to the Board their appointment and removal.

The company shall disclose the remuneration policy and the evaluation criteria in its Annual Report.

C. The Chairman of the nomination and remuneration committee could be present at the AGM, to answer the shareholders’ queries. However, it would be up to the Chairman to decide who should answer the queries.

Committee is applicable to the following classes of Companies:

(i) Every listed Company

(ii) Every other Public Company

(a) Having Paid up capital of Rs.10 crores or more; or

(b) Having turnover of Rs.100 Crores:

- Which have, in aggregate, outstanding loans or borrowings or debentures or deposits exceeding Rs.50 Crores.
- The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.

The above mentioned companies shall constitute the Nomination and Remuneration Committee consisting of –

- 3 or more NEDs out of which not less than one half shall be IDs.
- The chairperson of the company (whether executive or non-executive) may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such Committee.

The Nomination and Remuneration Committee shall-

- Identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, Recommend to the Board their appointment and removal, carry out evaluation of every director’s performance.
| 16. | **Appointment of one Woman Director** | **Clause 49 (II)(A):**
The Board of Directors of the company shall have an optimum combination of executive and non-executive directors with at least one woman director and not less than fifty percent of the Board of Directors comprising non executive Directors. |
|---|---|---|

Formulate the criteria for determining qualifications, positive attributes and independence of a director and Recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees. The Nomination and Remuneration Committee shall ensure that –

(a) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully;

(b) relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and

(c) remuneration to directors, KMPs and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals:

The policy shall be disclosed in the Board’s report.

**Section 149(1) and Companies (Appointment and Qualification of Directors) Rules, 2014:**

(i) every listed company;

(ii) every other public company having -

(a) paid–up share capital of Rs.100 Crores or more; or

(b) turnover of Rs.300 Crore or more shall appoint at least one woman director.

A company shall comply with provisions within a period of six months from the date of its incorporation.
Any intermittent vacancy of a woman director shall be filled up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy whichever is later.

### Section 165:
A person shall hold not office as a director, including any alternate directorship in more than 20 companies. The max no. of public companies in which a person can be appointed as a director shall not exceed 10.

### Clause 49 (II)(B)(3):
A person shall not serve as an independent director in more than seven listed companies. Any person who is serving as a whole time director in any listed company shall serve as an independent director in not more than three listed companies.

### Section 149:
An independent director shall hold office for a term up to five consecutive years on the Board of a company, but shall be eligible for reappointment for another term of up to five consecutive years on passing of a special resolution by the company and disclosure of such appointment in the Board’s report. No independent director shall hold office for more than two consecutive terms, but such independent director shall be eligible for appointment after the expiration of three years of ceasing to become an independent director.

### Clause 49 (II)(B):
An independent director shall hold office for a term up to five consecutive years on the Board of a company and shall be eligible for reappointment for another term of up to five consecutive years on passing of a special resolution by the Board. A person who has already served as an independent director for five years or more in a company as on October 1, 2014 shall be eligible for appointment, on completion of his present term, for one more term of up to five years only.

An independent director, who completes his above mentioned term shall be eligible for appointment as independent director in the company only after the expiration of three years of ceasing to be an independent director in the company.

### Clause 49 (VI):
The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the company. The company shall also constitute a Risk Management Committee. The Board shall define the roles and responsibilities of the Risk Management Committee.

### Section 134(3):
A statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company.
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| **20. Succession planning** | **Clause 49 (II)(D) (6):**  
The Board of the company shall satisfy itself that plans are in place for orderly succession for appointments to the Board and to senior management | There is no such provision. |
| **21. Filing of Casual Vacancy of IDs** | **Clause 49 (II)(D):**  
An independent director who resigns or is removed from the Board of the Company shall be replaced by a new independent director at the earliest but not later than the immediate next Board meeting or three months from the date of such vacancy, whichever is later  
Where the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director shall not apply. | **Schedule IV:**  
An independent director who resigns or is removed from the Board of the company shall be replaced by a new independent director within a period of not more than one hundred and eighty days from the date of such resignation or removal, as the case may be. Where the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director shall not apply. |
| **22. Code of Conduct of Board of Directors & Senior Management** | All Board members and senior management personnel shall affirm compliance with the code on an annual basis. The Annual Report of the company shall contain a declaration to this effect signed by the CEO.  
The Code of Conduct shall suitably incorporate the duties of Independent Directors as laid down in the Companies Act, 2013. | **Section 149 & Part III of Schedule IV:**  
The independent directors shall—  
(1) undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company;  
(2) seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice and opinion of outside experts at the expense of the company; |
(3) strive to attend all meetings of the Board of Directors and of the Board committees of which he is a member;

(4) participate constructively and actively in the committees of the Board in which they are chairpersons or members;

(5) strive to attend the general meetings of the company;

(6) where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, insist that their concerns are recorded in the minutes of the Board meeting;

(7) keep themselves well informed about the company and the external environment in which it operates;

(8) not to unfairly obstruct the functioning of an otherwise proper Board or committee of the Board;

(9) pay sufficient attention and ensure that adequate deliberations are held before approving related party transactions and assure themselves that the same are in the interest of the company;

(10) ascertain and ensure that the company has an adequate and functional vigil mechanism and to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use;

(11) report concerns about unethical behaviour, actual or suspected fraud or violation
of the company’s code of conduct or ethics policy;

(12) acting within his authority, assist in protecting the legitimate interests of the company, shareholders and its employees;

(13) not disclose confidential information, including commercial secrets, technologies, advertising and sales promotion plans, unpublished price sensitive information, unless such disclosure is expressly approved by the Board or required by law.

23. Disclosure of Appointment of Director

<table>
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<th>Clause 49(VIII)(G):</th>
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<td>The letter of appointment of the independent director along with the detailed profile shall be disclosed on the websites of the company and the Stock Exchanges not later than one working day from the date of such appointment.</td>
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A return containing the particulars of appointment of director or key managerial personnel and changes therein, shall be filed with the Registrar in Form DIR-12 along with such fee as may be provided in the Companies (Registration Offices and Fees) Rules, 2014 within thirty days of such appointment or change, as the case may be.

24. Disclosure of Resignation of Director

<table>
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<tr>
<th>Clause 49(VIII)(F):</th>
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<td>The company shall disclose the letter of resignation along with the detailed reasons of resignation provided by the director of the company on its website not later than one working day from the date of receipt of the letter of resignation. The company shall also forward a copy of the letter of resignation along with the detailed reasons of resignation to the stock exchanges not later than one working day from the date of receipt of resignation for dissemination through its website.</td>
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Section 169:

A director may resign from his office by giving a notice in writing to the company and the Board shall on receipt of such notice take note of the same and the company shall intimate the Registrar in such manner, within 30 days in form DIR-12 and shall also place the fact of such resignation in the report of directors laid in the immediately following general meeting by the company. Where a director resigns from his office, he shall within a period of thirty days from the date of resignation, forward to the Registrar a copy of his resignation along with reasons for the resignation in Form DIR-11 along with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014.

*Reference: http://taxguru.in/company-law/clause-49-companies-act-2013.html*
SEBI (Listing of Specified Securities on Institutional Trading Platform) Regulations, 2013

SEBI notified a new set of regulations called the SEBI (Listing of Specified Securities on Institutional Trading Platform) Regulations, 2013 (ITP Regulations) and amended the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 to insert a new “Chapter XC “Listing and Issue of Capital by Small and Medium Enterprises on Institutional Trading Platform without Initial Public Offering”. The provisions relating to ITP Regulations are covered under Regulations 106W to 106ZE.

Key highlights of the Regulations

Under these Regulations, a separate institutional trading platform is available in an SME exchange for listing and trading of specified securities of SMEs for informed investors. Such listing may be availed of without going through a public offering process. In other words, this provides exit options to investors even where the company or the promoters do not require additional capital to be raised from the public. Chapter XB of the ICDR Regulations provides for issuance of specified securities by SMEs on SME exchange. Broadly, an SME was required to make an IPO without having to file the draft offer document with SEBI. Here, SME is defined to mean a public company, including Start-up Company that complies with all the eligibility conditions specified in these Regulations. The main highlights of the regulation are as under:

(i) Eligibility criteria

For SME to be eligible to list its specified securities on the ITP, the following requirements should be satisfied:

(a) The name of promoter, Group Company or director should not appear on the wilful defaulters list of Reserve Bank of India maintained by CIBIL.

(b) There should be no winding up petition against the company admitted by a competent court.

(c) The company, group companies or subsidiaries have not been referred to BIFR within a period of 5 years prior to the date of application for listing;

(d) No regulatory action has been taken against the company, its promoter or directors, by the SEBI, RBI, IRDA, MCA within a period of 5 years prior to the date of application for listing;

(e) The incorporation of the company should be atleast one year old and not more than 10 years.

(f) The revenues of the company have not exceeded one hundred crore rupees in any of the previous financial years.

(g) The paid up capital of the company has not exceeded twenty five crore rupees in any of the previous financial years.
(h) The company has at least one full year's audited financial statements, for the immediately preceding financial year at the time of making the listing application.

(i) In addition to above, the company should have received minimum prescribed investment in terms of the specified regulation from any one of the following entities such as Alternative Investment Fund/ Venture Capital Fund/ other category of investors approved by SEBI(ii) Angel Investor, (iii) Registered Merchant Banker,(iv) a QIB, (v) a specialized International Multilateral Agency or domestic agency or a Public Financial Institution, (vi) receipt of finance from a scheduled bank for its project financing or working capital and a period of three years has been elapsed from the date of such financing and the funds so received have been fully utilized.

(ii) **Restriction on further issue of securities**
Listing of specified securities on the ITP cannot be accompanied by any issue of securities to the public in any manner. Further, the SME cannot undertake an IPO while its specified securities are listed on the ITP.

(iii) **Procedure for Listing**
1. Submission of Information Memorandum (IM) as per the prescribed format.
2. The IM should be on the Recognised Stock Exchange website 21 days from date of filing.
3. Recognised Stock Exchange shall grant In-Principle approval.
4. The Principle approval from Recognised Stock Exchange shall be the deemed waiver by SEBI for Section 19(2)(b) (7) of Securities Contract Regulations Act i.e. listing without public offering.

(iv) **Post Issue Conditions for Fund Raising**
1. No other securities of the company shall be listed other than the Specified Securities.
2. No IPO shall be made by the company for listing on ITP.
3. The company may raise capital through private placement or rights issue without an option for renunciation of rights subject to the guidelines mentioned in the notification.

(v) **Minimum Promoter Shareholding and Lock-In**
At least 20% of the post listed capital shall be held by the promoters at the time of listing which shall be locked-in for a period of three years from date of listing.

(vi) **Exit from Institutional Trading Platform**
1. A company whose specified securities are listed on institutional trading platform may exit from that platform, if:
   (a) Its 90% of total votes and the majority of non-promoter votes have been cast in favour of such proposal.
   (b) The recognised stock exchange approves such exit.
2. A company whose securities are listed on institutional trading platform shall exit the platform within a period of 18 months upon happening of following event of:
(a) Its specified securities have been listed on this platform for a period of ten years;
(b) The company has paid up capital of more than twenty five crore rupees;
(c) The company has revenue of more than three hundred crore rupees as per the last audited financial statement; and
(d) The company has market capitalization of more than five hundred crore rupees.

3. A company be delisted and permanently removed from the trading platform on account of non-compliances with various clauses as below:
   (a) failure to file periodic filing with stock exchange for more than one year; or
   (b) failure to comply with corporate governance norms for more than one year; or
   (c) Non-compliance of the condition of listing as may be specified by the recognised stock exchange.

4. In case of a company delisted and permanently removed under the above mentioned non-compliances, no company promoted by the promoters and directors of such delisted company shall be permitted to be listed on ITP for a period of five years from the date of such delisting. Further this provision shall not apply to a company promoted by the independent directors of such delisted company.
Lesson 19
Insider Trading


Section 195 of the Companies Act, 2013 deals with the provisions on prohibition on insider trading of securities, which is as under:

Sub-section (1) lays down that no person including any director or key managerial personnel shall enter into insider trading. Provided that nothing contained in this sub-section shall apply to any communication required in the ordinary course of business or profession or employment or under any law.

(a) “Insider trading” means –

(i) an act of subscribing, buying, selling, dealing or agreeing to subscribe, buy, sell or deal in any securities by any director or key managerial personnel or any other officer of a company either as principal or agent if such director or key managerial personnel or any other officer of the company is reasonably expected to have access to any non-public price sensitive information in respect of securities of company, or

(ii) an act of counselling about, procuring or communicating directly or indirectly any non-public price sensitive information to any person;

(b) “Price-sensitive information” means any information which relates, directly or indirectly, to a company and which if published is likely to materially affect the price of securities of the company.

Sub-section (2) provides that if any person contravenes the provisions of this section, he shall be punishable with imprisonment for a term which may extend to five years or with fine which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher, or with both.
PROTECTION OF INVESTORS UNDER COMPANIES ACT, 2013

Acceptance of Deposits

Section 73 - This section provides that no Company shall accept or review deposit under this Act from the public except in a manner provided under Chapter V (Acceptance of Deposits by Companies) of Companies Act, 2013 and Companies (Acceptance of Deposits) Rules, 2014 made thereunder.

Sub-section 3 of section 74 lays down that if a company fails to repay the deposit or part thereof or any interest thereon within the time specified under section 74 or such further times as may be allowed by the Tribunal, the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one crore rupees but which may extend to ten crore rupees and every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both.

In terms of sub-section 4, where a Company fails to repay the deposit or part thereof, or any interest thereon the deposit for concerned may apply to the Tribunal for an order directing the company to pay the sum due or for any loss or damage incurred by him as a result of such non-payment and for such other orders as the Tribunal may deem fit.

Rule 21 of Companies (Acceptance of Deposits) Rules, 2014 stipulates that if any company referred to in sub-section (2) of section 73 or any eligible company inviting deposits or any other person contravenes any provisions of these rules for which no punishment is provided in the act, the company and every officer of the company who is in default shall be punishable with fine which may extend to five thousand rupees and where the contravention is a continuing one, with a further fine which may extend to five thousand rupees for every day after the first day during which the contraventions continue.

Mis-statements in Prospectus

Section 34 deals with criminal liability for mis-statement in prospectus issued by a company.

Section 34: Where a prospectus, issued, circulated or distributed, includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to be mislead, every person who authorises the issue of such prospectus shall be liable for action under section 447.

Section 447: Any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may
extend to three times the amount involved in the fraud. Provided that where the fraud in question involves public interest the terms of the imprisonment shall not be less than three years.

**Fraudulently inducing persons to invest money**

Section 36: Any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into-

(a) any agreement for, or with a view to, acquiring, disposing of, subscribing for or underwriting, securities;

or

(b) any agreement the purpose or the pretended purpose of which is to secure a profit or any of the parties form the yield of securities or by reference to fluctuations in the value of securities; or

(c) any agreement, for, or with a view to, obtaining credit facilities from any bank or financial institution, shall be liable for action under section 447.

**Personation for acquisitions, etc. of securities**

Section 38: Any person who –

(a) makes or abets making an application in a fictitious name to a company for acquiring, or subscribing for, its securities; or

(b) makes or abets making of multiple applications to the company in different names or in different combinations of his name or surname for acquiring or subscribing for its securities; or

(c) otherwise induces directly or indirectly a company to allot, or register any transfer thereof, securities to him, or to any other person in a fictitious name, shall be liable for action under section 447.

**Non-payment of Dividend**

*Section 123:* This section, inter alia, requires a company who has declared a dividend for any financial year to deposit the amount of such dividend (including interim dividend) in a scheduled bank in a separate account within 5 days from the date of declaration of such dividend.

*Section 124:* This section provides that where a dividend has been declared by a company which has not been paid or claimed within 30 days from the date of such declaration, the company shall within 7 days of expiry of the said period of 30 days transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by a company in this behalf in any scheduled bank to be called the unpaid dividend account.

This section also provide for penalty for non complying with the above requirement and the same by way of interest @ 12% per annum and the interest accruing on the amount of unpaid/unclaimed dividend not transferred to the unpaid dividend account.
Section 125: This section provides for establishment of Investors’ Education and Protection Fund by the Central Government. Various types of unpaid/unclaimed amounts of application money/matured deposits/matured debenture etc. are to be credited to the said fund. The said accumulation in this fund are to be utilized for promotion of investors’ awareness and protection of investors’ interests.

Further, if a company fails to comply with any of the requirements of Section 124, the company shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

Transfers and Transmission of Securities

Regarding transfers and transmissions of securities necessary provisions are available in Section 56, 58, 59 of the Companies Act, 2013. As regards listed companies, the clauses in the listing agreement contain provisions for prompt issue of certificates after effecting transfers.

Failure to comply with the provisions of Companies Act, 2013 can be brought before the Tribunal through an appeal under Section 58 and 59. After hearing the parties the Tribunal may by order direct the company to register the transfer.

Failure to Send Financial Statements

Section 136: This section provides for the right of a member to obtain copies of Balance-sheet and auditor’s Report.

Sub-section 3 provides that in case of default complying with this requirement, the company shall be liable for a penalty of twenty-five thousand rupees and every officer who is in default shall be liable to a penalty of five thousand rupees.

Besides, Section 436 permits the shareholder to proceed against the company and its officers in a court of law generally for offences committed under the Companies Act including prospectus, abridged prospectus, allotment, listing, transfer of shares, dividend payment etc. committed by the company as well as its officers under various provisions in the Act.

Protection to Debentureholders

Section 71 of the Companies Act, 2013 protects the debenture holds and contains stringent penalties for default and also empowers the denture trustee to makes an appeal to the Tribunal.