

A Critical Appraisal of Major Changes in Indian Companies Act

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ABSTRACT: For achieving compatibility with the fast changing business environment and economic scenario at national and international level; instead of making more amendments in the Indian Companies Act 1956, it has been replaced with a new Companies Act 2013 which is effective from 1st April, 2014. Many changes have been made in the new Act and many new concepts have also been introduced, such as One Person Company, dormant company, corporate social responsibility, chief executive officer, stakeholder's relationship committee, merger with foreign company etc. In this paper, an effort has been made for presenting a section-wise brief summary of some major changes in the Companies Act 2013 as compared to 1956 Act and its impact on corporate world.

Keywords: Companies Act 2013

INTRODUCTION

With the drastic changes in the business environment, social standards, international norms, it became necessary to make a large number of changes in the prevailing Indian Companies Act, 1956. In the past, many amendments had been incorporated in the 1956 Act from time to time but to make it compatible with present economic scenario, such a large number of changes were required that it had been decided to replace it with a new comprehensive Act instead of making amendments in it.

The long awaited Companies Bill was passed in the Lok Sabha on 18 December 2012 and in the Rajya Sabha on 8 August 2013. It has become Companies Act, 2013 after obtaining consent of President of India on 29th August 2013. It has come into force with effect from 1st April 2014.

Although the number of sections is reduced from 658 to 470 but the new Act is much clear, comprehensive and it encompasses many new concepts. Changes have been made in every field such as management, accounts, audit, disclosures, mergers, dissolution, etc. It is not possible to cover all the changes in a small article. In this paper, an attempt has been made to analyze some major changes and its impact on corporate world.

MAJOR CHANGES AND ITS IMPACT

➤ No Regional Considerations [Sec 1]

According to Sec 1(2), the Companies Act, 2013 extends to the whole of India. In Companies Act, 1956, the Central Government was empowered to exempt companies in Goa, Daman, Diu and Jammu & Kashmir from the provisions of the 1956 Act and it had also power to make modification in application of different provisions of the Act to such companies.

Impact—The power of Central Government to exempt companies from provisions of Companies Act on the basis of regional considerations has

ended. Thus, now there is no difference among companies on basis of regional differentiation.

➤ Accounting and Auditing Standards [Sec 2(7)]

There was no provision regarding auditing standards in the Companies Act 1956. It recognized only accounting standards. But the new Act provides statutory recognition to auditing standards along with accounting standards.

Impact—Adherence to accounting and auditing standards will provide uniformity and consistency to maintenance and disclosure of accounts of different companies. It will help in making comparative analysis among companies and compliance with auditing standards will also be helpful in detecting frauds and errors.

➤ Maintenance of Books of Accounts and Other Papers in Electronic Mode [Sec 2(12)]

This section of Companies Act, 2013 states that 'book and paper' and 'book or paper' include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or electronic form. There was no mention about maintenance of books and other documents in electronic mode in 1956 Act.

Impact—Recognition to maintenance of books and papers in electronic form indicates compatibility of the New Act with technological upgradation. This clause will be beneficial in enhancing quick and easy accessibility to all kinds of documents.

➤ Chief Executive Officer and Chief Financial Officer [Sec 2(18) & 2(19)]

Statutory recognition is provided to two new terms 'Chief Executive Officer' and 'Chief Financial Officer' by the New Companies Act. There was no recognition to these posts in the earlier 1956 Act.

Impact—This clause will motivate companies to make changes in their management hierarchy. At the same time it will also motivate companies to

appoint more professional experts to these posts and it will lead to enhanced professionalism at corporate level.

➤ **Inclusion of Cash Flow Statement in Financial Statement [Sec 2(40)]**

In Companies Act, 1956 only Balance Sheet and Profit & Loss Account or Income and Expenditure Account were included under financial statement. In New Companies Act, Cash Flow Statement has also become a mandatory part of financial statement along with balance sheet and profit and loss account. Another statement has also been included in this category which is known as 'statement of changes in equity' (wherever applicable). A notable thing in this regard is that in case of One Person Company, Small Company and Dormant Company, cash flow statement is not a compulsory part of financial statement.

Impact—Cash flow statement is important for those companies also which prepare their accounts on accrual basis and to emphasize this fact preparation of cash flow statement has been mandated by the new Act. This clause will help in disclosing clearly the liquidity position of the company to its stakeholders.

➤ **Uniform Financial Year [Sec 2(41)]**

According to Companies Act 2013, the financial year of every company must end on 31 March every year, which is the same period as is required for tax reporting purposes. An Indian company which is a holding company or a subsidiary of a foreign company requiring consolidation outside India will have an option to apply to the National Company Law Tribunal to follow a different period as its financial year. Existing companies have two years to align their financial year with the new requirements. The 1956 Act did not require companies or bodies corporate to adopt 1st April-31st March as the financial year.

Impact—This clause will bring consistency to maintenance of accounts among different companies as all of them have to follow the same period as their financial year. It will not only be helpful in making comparative analysis but also be beneficial in resolving problems regarding computation of tax.

➤ **Formation of One Person Company [Sec 2(62)]**

The New Companies Act introduces the concepts of a one person company and a small company which will not have to comply with certain requirements relating to reporting, board meetings and other procedural matters. According to Sec 2(62), 'one person company' means a company which has only one person as a member. The concept of One Person Company did not exist in the earlier companies Act.

Impact—One person company is a new type of company and as it requires only one person to form

the company, hence it will lead to formation of more companies. Many entrepreneurs will prefer company form of business organization instead of sole proprietorship. The biggest problem of sole proprietorship, i.e. lack of financial resources can be solved to a great extent by adopting the company form of business organization. Thus, the concept of One Person Company will lead to overall growth of entrepreneurship in the country.

➤ **Number of members in Private Company [Sec 2(68)]**

In 1956 Act, minimum and maximum number of members in case of private company was 2 and 50 respectively. Companies Act 2013 has increased the maximum number of members from 50 to 200. Besides this, the minimum limit of two members also does not exist with the introduction of concept of One Person Company.

Impact—Increase in number of maximum members will lead to involvement of more people in private companies and that will prove helpful in arrangement of funds for the company.

➤ **15 Types of Companies [Sec 3]**

A company can be a private company or a public company and it can be limited by shares or limited by guarantee or unlimited. Formation of 10 different types of companies was possible under Companies Act, 1956 by making different combinations between nature of company and nature of liability. With the introduction of concept of 'One Person Company' in 2013 Act, now 15 different types of companies can be formed under the new companies Act. Special provisions regarding formation of One Person Company are given in Section 3.

Impact—Now entrepreneurs have more flexibility in choice of appropriate form of company for themselves. This flexibility can result into tremendous growth in number of companies in future.

➤ **Compulsion for Articles [Sec 5]**

Under 1956 Act, Articles was not compulsory for public companies limited by shares; for other companies it was compulsory. But the New Companies Act makes it compulsory for every company to have its own articles. Besides that inclusion of entrenchment provisions in articles is also permitted which was not allowed in earlier Companies Act.

Impact—There will be more clarity in internal rules regarding operation of various Activities to be conducted by the company.

➤ **Refund of Application Money [Sec 39]**

According to this section, if the stated minimum amount has not been subscribed and the sum payable on application is not received within a period of thirty days from the date of issue of the prospectus, or such other period as may be

specified by the SEBI, the amount received on application shall be returned.

Under the Companies Act 1956, application money had to be returned within 120 days after the first issue of the prospectus if stated minimum amount is not received.

Impact—This clause has been included in the Act for the benefit of investors. Shortening in period for refund of application money is obviously in the interests of investors because now they will earlier get the opportunity to invest their money in other schemes or projects and they do not have to bear the loss of interest on their investment due to delay in refund.

➤ **Global Depository Receipt [Sec41]**

Section 41 of Companies Act, 2013 states 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.”

There was no mention regarding GDR in Companies Act, 1956.

Impact—Inclusion of provision regarding GDR in the new Act indicates the recognition of importance of this financial instrument. It will be helpful in acquiring foreign funds.

➤ **Prohibition on Issue of Shares at Discount [Sec 53]**

In Companies Act 1956, issue of shares at discount was allowed after following some prescribed conditions. But according to 2013 Act, any share issued by a company at a discounted price shall be void. Only sweat equity shares can be issued at discount. Thus, issue of shares at discount is totally prohibited by the new companies Act and there is also provision for punishment and fine for contravention of this clause.

Impact—For attracting investors, companies adopt the policy of issuing shares at discount but it ultimately results into capital loss and the company has to bear the financial burden. Now, this new clause will stop this practice and that will ultimately lead to sound financial position.

➤ **Restriction on Reduction of Capital [Sec 66]**

According to new Act, no reduction in capital shall be made if the company is in arrears in the repayment of any deposits accepted by it, either before or after the commencement of this Act, or the interest payable thereon. There was no such restriction on reduction of capital in the 1956 Act. Another important change is that petition for confirming reduction is to be made to Tribunal instead of court.

Yet another notable point is that provisions for reduction of capital shall not apply to buy-back of its own securities by a company if buy-back is made in strict compliance with section 68 of the 2013 Act. If buy-back does not comply with

section 68 of the 2013 Act, it is a reduction of capital. There was no provision regarding it in 1956 Act.

Impact—More power is given to Tribunal by the new Act. Restriction on reduction of capital in case of default in repayment of deposits will be helpful in safeguarding the interests of investors. This section also clarifies doubts regarding application of provisions for reduction of capital in case of buy-back of securities.

➤ **Prohibition on Acceptance of Deposits from Public [Sec 73]**

In 1956 Act, every public company was allowed to accept public deposits but according to the new Act, only those public companies having prescribed net worth or turnover may invite, accept or renew deposits from the public. The new Act also makes deposit insurance compulsory for acceptance of deposits from the public or members. Besides that other rules for accepting deposits has also become more stringent.

Impact—Stringent rules for acceptance of deposits and compulsory deposit insurance will help in protecting rights of investors.

➤ **Change in Period of First Annual General Meeting [Sec 96]**

According to 2013 Act, in case of first annual general meeting, it shall be held within a period of nine months from the date of closing of the first financial year of the company. In 1956 Act, it was provided that the first annual general meeting of a company shall be held within 18 months from the date of its incorporation.

Impact—This change will be helpful to the stakeholders in better understanding of the financial position of the company.

➤ **Increase in Quorum Requirements [Sec 103]**

According to new Act, unless the articles of the company provide for a large number; in case of a public company—(i) five members personally present if the number of members as on the date of meeting is not more than one thousand, (ii) fifteen members personally present if the number of members as on the date of meeting is more than one thousand but up to five thousand, (iii) thirty members personally present if the number of members as on the date of meeting exceeds five thousand shall be the quorum for a meeting of the company.

Under the 1956 Act, the quorum requirement for public companies for general meetings was 5 members personally present unless the articles stipulated a large number. Thus, the quorum requirement was not based on number of members of the company.

Impact—Increase in quorum requirements on the basis of number of members will obviously ensure participation of more members in the meeting and that will work in the interest of shareholders.

➤ **Restriction on Voting Rights in Private Companies [Sec 106]**

According to Companies Act 2013, “Notwithstanding anything contained in this Act, the articles of a company may provide that no member shall exercise any voting right in respect of any shares registered in his name on which any calls or other sums presently payable by him have not been paid, or in regard to which the company has exercised any right of lien.

Under the 1956 Act, this restriction was applicable only to public companies and not to private companies.

Impact—Applicability of restriction on voting rights in case of non-payment of calls to private companies will prove beneficial in acquiring regular payment on calls.

➤ **Voting through Electronic Means [Sec 108]**

According to Sec 108 of the new Companies Act, the Central Government may prescribe the class or classes of companies and manner in which a member may exercise his right to vote by the electronic means. There was no mention regarding it in 1956 Act.

Impact—Recognition to voting through electronic means is a step towards progress with technological advancement.

➤ **Minutes of Meetings of Shareholders and Creditors [Sec 118]**

The 2013 Act requires minutes to be kept of meeting of any class of shareholders and creditors also. It has also become compulsory to keep minutes of every resolution passed by postal ballot. These things were not compulsory under 1956 Act. Besides that compliance with secretarial standards with respect to general and board meetings specified by the Institute of Company Secretaries of India has also been made compulsory by the new Companies Act.

Impact—Compliance with standards of ICSI will bring consistency to the proceedings of meetings and compulsion for keeping minutes of every meeting will bring transparency to working procedure of companies.

➤ **Declaration of Dividend [Sec 123]**

Under the 1956 Act, it was compulsory to transfer a certain percentage of profit to reserve and setting off of past losses (if any) before declaration of dividend but there is no such compulsion in the new Companies Act. Similarly, according to new Act, the Central Government has no power to permit companies for declaration of dividend without charging depreciation. Prohibition on

declaration or payment of dividend from any reserve other than free reserve has also been clarified by this section of the new Act. Two new provisions are also added in this context. Now, declaration or payment of dividend is barred if the company is in default of repayment of deposits. Another point is that payment of dividend to shareholders through electronic mode has also been recognized.

Impact—Payment through electronic mode will ensure easy and quick payment to the shareholders. Prohibition on declaration or payment of dividend without charging depreciation and repayment of deposits will lead to sound financial position of the company.

➤ **Mandatory Consolidated Financial Statements [Sec 129]**

There was no mention regarding consolidated financial statements in 1956 Act. According to the new Act, Consolidated Financial Statements are mandatory for companies having one or more subsidiaries or associates or joint ventures.

Impact—Consolidated financial statements will help stakeholders in clear understanding of situation of the company along with its subsidiaries.

➤ **Constitution of National Financial Reporting Authority [Sec 132]**

According to this section, the Central Government may, by notification, constitute a National Financial Reporting Authority (NFRA) to provide for matters relating to accounting and auditing standards under this Act. Actually, it has replaced the National Advisory Committee on Accounting Standards (NACAS) established under 1956 Act. NACAS was a mere advisory body under the 1956 Act but the 2013 Act renamed it as NFRA and has converted it into a body with quasi-judicial powers to discipline CAs.

Impact—Providing more powers to NFRA will help in smooth administration of matters regarding compliance of accounting and auditing standards.

➤ **Corporate Social Responsibility [Sec 135]**

CSR has been made mandatory for Indian companies with a net worth of ` 500 crores or more, or a turnover of ` 1,000 crores or more, or net profits of ` 5 crores or more during any financial year. Such companies will be required to establish a CSR committee to formulate a CSR policy and to recommend expenditure of CSR projects. The company is required to spend at least 2% of the company’s average annual net profits over the preceding three financial years on social and charitable causes annually in accordance with its CSR policy.

It is a completely new provision and there was no mention regarding mandatory CSR policy or expenditure in 1956 Act.

Impact—There will be a financial burden on the companies due to mandatory expenditure on CSR projects but in the long run, it will be in the interest of the company itself as such tasks by the company will enhance its reputation in the society.

➤ **Mandatory Internal Audit [Sec 138]**

Internal audit was not compulsory under 1956 Act. According to the new Act, such class or classes of companies as may be prescribed shall be required to appoint an internal auditor, who shall either be a chartered accountant 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. Time intervals and manner of conducting internal audit shall be prescribed by the Central Government.

Impact—Mandatory internal audit will help in detecting errors and frauds at an earlier stage and that will lead to sound and smooth management of the company. Besides that, appointment of professionals as internal auditors will ensure strict compliance with auditing standards.

➤ **Appointment of Auditors [Sec 139]**

In the new Act, system of time bound annual appointment or reappointment of auditors by Controller and Auditor General of India (CAG) for government companies has been implemented. Furthermore, listed companies and some prescribed classes of companies must implement compulsory rotation for auditors. They may not appoint auditors for (i) more than two consecutive five year terms if the auditor is an audit firm; or (ii) for more than one term of five consecutive years if the auditor is an individual.

Impact—Compulsory rotation and time bound appointment of auditors can be helpful in preventing frauds by auditors.

➤ **Directors [Sec 149]**

Many changes have been made in the new Companies Act regarding appointment, qualifications, number of directors. Under the new Act the number of directors that any Indian company can have has been increased to 15 directors. This can be increased further by the passing of a special resolution. Certain classes of companies as may be prescribed must now have a female director. Every company must now have a director who resided in India for 182 days or more in the previous calendar year. One-third of the number of directors of every listed public company must be independent directors. Certain classes of public (non-listed) companies will also have to appoint such number of independent directors as may be prescribed. Independent directors are not entitled to stock options. The new Companies Act

also prescribes what attributes a person must have to be an independent director.

Impact—Compulsion of female director in the board of directors is a step towards women empowerment at corporate level. Besides that the concept of independent director and 182 day clause will also be helpful in ensuring smooth management.

➤ **Nomination and Remuneration Committee and Stakeholders Relationship Committee [Sec 178]**

There was no mention regarding constitution of this committee in 1956 Act. According to new Act, the Board of Directors of every listed company and such other class or classes of companies, as may be prescribed shall constitute the Nomination and Remuneration Committee consisting of three or more non-executive directors out of which not less than one half shall be independent directors. This committee shall identify persons who are qualified to become directors and who may be appointed in senior management. It shall also carry out evaluation of every director's performance.

The Board of Directors of a company which consists of more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year shall constitute a Stakeholders Relationship Committee for resolving grievances of security holders of the company.

Impact—Nomination and Remuneration Committee will help in appointment of competent directors and timely evaluation of directors' performance will ensure smooth and proper management. Constitution of Stakeholders Relationship Committee for resolving grievances of security holders will be very beneficial for investors.

➤ **Related Party Transactions [Sec 188]**

Under the previous Companies Act, the approval of Central Government was required before a company could enter into certain related party transactions. Under the new Companies Act directors can approve the entry into related party transactions by the company provided that certain financial conditions are not exceeded. Meaning and scope of 'related party' and 'related party transactions' have also been widened in the new act.

Impact—Concept of related party transactions is more clarified and simplification of clauses will help in conducting and understanding related party transactions.

➤ **Establishment of Serious Fraud Investigation Office [Sec 211]**

It is a new provision. The Central Government shall, by notification, establish an office to be called the Serious Fraud Investigation Office to investigate frauds relating to a company.

Impact—Such kind of office will obviously help a lot in investigation into matters relating to fraud and that will be in the interest of stakeholders.

➤ **Merger or Amalgamation of Company with Foreign Company [Sec 234]**

It is also a new provision. Due to this provision, cross border mergers can now easily be completed. It enables mergers between companies registered under the 2013 Act and foreign companies with the prior approval of Reserve Bank of India. Earlier mergers were possible only if the transferee company was an Indian Company.

Impact—Easy mergers with foreign companies will act as an effective way for attracting foreign capital into the country.

➤ **Dissolution of Company by Tribunal [Sec 302]**

According to this Section, when the affairs of a company have been completely wound up, the company liquidator shall make an application to the Tribunal for dissolution of such company. Besides that, the Tribunal has also power to make order for dissolution of a company if in its opinion it is just and reasonable in the circumstances of the case that an order for the dissolution of the company should be made. In the previous Act, such powers remained with the Court.

Impact—More power is given to the tribunal in matters relating to dissolution of company and interference of court has been minimized.

➤ **Mediation and Conciliation Panel [Sec 442]**

According to this Section, the Central Government shall maintain a panel of experts to be called as the Mediation and Conciliation Panel consisting of such number of experts having such qualifications as may be prescribed for mediation between the parties during the pendency of any proceedings before the Central Government or the Tribunal or the Appellate Tribunal under this Act. There was no concept of any such panel in the 1956 Act.

REFERENCES

1. Companies Act, 2013
2. Indian Companies Act, 1956

Impact—Such type of panel will help a lot in resolving legal issues in a short time span.

➤ **Punishment for Fraud [Sec 447]**

There was no provision regarding punishment for fraud in the 1956 Act; even the term ‘fraud’ had also not been defined. But in the new Act, Sec 447 provides for strict punishment and fine against persons committing frauds.

Impact—Clause for strict punishment can be helpful in preventing frauds in companies.

➤ **Dormant Company [Sec 455]**

2013 Act also introduces the concept of Dormant Company. Where a company is formed or registered under this Act for a future project or to hold an asset or intellectual property and has no significant accounting transaction, such a company or an inactive company may make an application to the Registrar for obtaining the status of a dormant company.

Impact—Burden of legal formalities is comparatively less for dormant company.

CONCLUSION

The new Indian Companies Act is a positive step towards modernizing company law of India and making it compatible with global standards. It has given increased decision making powers to the company and Tribunal. Introduction of One Person Company, Dormant Company and small company should alleviate some of the administrative burdens that small businesses have to bear, but larger companies should prepare themselves for further administrative burdens as a result of changes in the appointment of auditors and directors. Recognition to voting through electronic means, maintenance of accounts and documents in electronic mode is also a step towards technological advancement. Similarly, compulsion of female director, independent directors, expenditure on corporate social responsibility will be in the interest of society and different class of stakeholders. Establishment of Stakeholders Relationship Committee, Mediation and Conciliation Panel will be helpful in resolving conflicts. Similarly, Serious Fraud Investigation Office, provision for punishment for frauds, mandatory internal audit will help in detecting and preventing frauds.