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CHAPTER 1 – PRELIMINARY

UNIT I: INTRODUCTION TO COMPANIES ACT, 2013

The will to succeed is important. But what is more important is the will to prepare.

1. INTRODUCTION

The Companies Act, 2013 is an Act to consolidate and amend the law relating to companies.

The Companies Act, 2013 received the assent of the Hon'ble President of India on 29th August, 2013 and was notified in the Official Gazette on 30th August, 2013 for public information stating that different dates may be appointed for enforcement of different provisions of the Companies Act,2013, through notifications.

Example: Section 1 came into force on 30th August, 2013; 98 sections came into force on 12th September, 2013; 143 sections were enforced from 1st April, 2014 and so on.

The Companies Act, 2013 is Rule based legislation with 470 sections and seven schedules. The entire Act has been divided into 29 chapters.

2. SHORT TITLE, EXTENT, COMMENCEMENT AND APPLICATION [SECTION 1]

Short Title: This Act may be called as the Companies Act, 2013.

Extend: The Act shall extend to the whole of India.

Commencement: This section shall come into force at once and the remaining provisions of this Act shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint and different dates may be appointed for different provisions of this Act.

Applicability: The provisions of this Act shall apply to-

a) Companies incorporated under this Act or under any previous company law*;

b) Insurance companies, except in so far as the said provisions are inconsistent with the provisions of the Insurance Act, 1938 or the Insurance Regulatory and Development Authority Act, 1999;

c) Banking companies, except in so far as the said provisions are inconsistent with the provisions of the Banking Regulation Act, 1949;

d) Companies engaged in the generation or supply of electricity, except in so far as the said provisions are inconsistent with the provisions of the Electricity Act, 2003;

e) Any other company governed by any special Act for the time being in force, except in so far as the said provisions are inconsistent with the provisions of such special Act, and

f) Such body corporate, incorporated by any Act for the time being in force, as the Central Government may,

by notification, specify in this behalf, subject to such exceptions, modifications or adaptation, as may be specified in the notification. Example: Food Corporation of India (FCI), NHAI etc.

For example: Food Corporation of India (FCI), National Highway Authority of India (NHAI) etc.

Note: The term "except in so far as" shall mean excluding to the extent of i.e. if any provision of the Companies Act is inconsistent with any of the provisions of other Act (Insurance Act, Banking Regulation Act, Electricity Act, etc.) to which the company is regulated than that company shall comply with the provisions of respective Act/Acts to which it is governed and regulated by.

For example: ABC Ltd. was incorporated on 1.1.1912 under the Indian Companies Act, 1882. So, the Companies Act, 2013 shall also be applicable on ABC Ltd.

3. DEFINITIONS [SECTION 2]

Section 2 of the Companies Act, 2013 is a definition section. It provides various terminologies used in the Act.

Definitional Sections or Clauses, are known as 'internal aids to construction' and can be of immense help in interpreting or construing the enactment or any of its parts.

1) **Board of Directors or Board,** in relation to a company, means the collective body of the directors of the company.

2) **Contributory** means a person liable to contribute towards the assets of the company in the event of its being wound up

   Explanation: For the purpose of this clause, it is hereby clarified that a person holding fully paid-up shares in a company shall be considered as a contributory.

3) **Control** shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner;

   It is an inclusive definition and relevant for the provisions relating to subsidiary and holding companies. This definition is also relevant for the definition of subsidiary given under section 2(87).

4) **Financial year,** in relation to any company or body corporate, means the period ending on the 31st day of March every year, and where it 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.

   Provided that where a company or body corporate, which is a holding company or a subsidiary or associate company of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, the Central Government may, on an application made by that company or body corporate in such form and manner as may be prescribed, allow any period as its financial year, whether or not that period is a year:

   Provided also that any application pending before the Tribunal as on the date of commencement of the Companies (Amendment) Ordinance, 2019, shall be disposed of by the Tribunal in accordance with the provisions applicable to it before such commencement.

   Provided also that a company or body corporate, existing on the commencement of this Act, shall, within a period of two years from such commencement, align its financial year as per the provisions of this clause.

   Note: The term "company incorporated outside India" refers to Foreign Company incorporated under any applicable laws for the constitution of company outside India.

   Example: Reliance Industries Limited, a company incorporated in year 1973, follows 1st January to 31st December as its financial year. Now after the commencement of Companies Act, 2013, Reliance Industries Limited is required to align its financial year as financial year ending as on 31st March of every year within 2

years from such commencement.

5) **Free reserves** mean such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend:

Provided that—

a) any amount representing Unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or

b) any change in carrying amount of an asset or of a liability recognized in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value,

shall not be treated as free reserves;

6) **Manager** means an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called, whether under a contract of service or not;

7) **Managing Director** means a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

Explanation— For the purposes of this clause, the power to do administrative acts of a routine nature when so authorised by the Board such as:

a) the power to affix the common seal of the company to any document or
b) to draw and endorse any cheque on the account of the company in any bank or
c) to draw and endorse any negotiable instrument or
d) to sign any certificate of share or to direct registration of transfer of any share,

shall not be deemed to be included within the substantial powers of management;

Explanation- For any individual to be called as managing director, an individual shall first be a director duly appointed by the Company under the provisions of the Companies Act, 2013. This also implies that an individual who is not a director in the company cannot be appointed as Managing Director of that company.

8) **Net worth** means the aggregate value of the paid-up share capital and all reserves created out of the profits, securities premium account and debit or credit balance of profit and loss account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation;

9) **Officer** includes any director, manager or key managerial personnel or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act;

10) **Officer who is in default,** for the purpose of any provision in this Act which enacts that an officer of the company who is in default shall be liable to any penalty or punishment by way of imprisonment, fine or otherwise, means any of the following officers of a company, namely:

i) whole-time director (WTD);

ii) key managerial personnel (KMP);

iii) where there are no key managerial personnel, such director or directors as specified by the Board in this behalf and who has or have given his or their consent in writing to the Board to such specification, or all the directors, if no director is so specified;

iv) any person who, under the immediate authority of the Board or any key managerial personnel, is charged with any responsibility including maintenance, filing or distribution of accounts or records, authorises, actively participates in, knowingly permits, or knowingly fails to take active steps to prevent, any default;

v) any person in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act, other than a person who gives advice to the Board in a professional capacity;

vi) every director, in respect of a contravention of any of the provisions of this Act, who is aware of such contravention by virtue of the receipt by him of any proceedings of the Board or participation in such proceedings without objecting to the same, or where such contravention had taken place with his consent or connivance;

vii) in respect of the issue or transfer of any shares of a company, the share transfer agents, registrars and merchant bankers to the issue or transfer;

Example:

In a company, a default was committed with respect to the allotment of shares by the officers. In company there were no managing director, whole time director, a manager, secretary, a person charged by the Board with the responsibility of complying with the provisions of the Act, and neither any director/directors specified by the board. Therefore, in such situation, all the directors of the company may be treated as officers in default.

11) Register of companies means the register of companies maintained by the Registrar on paper or in any electronic mode under this Act;

12) Related party, with reference to a company, means—

i) a director or his relative;

ii) a key managerial personnel or his relative;

iii) a firm, in which a director, manager or his relative is a partner;

iv) a private company in which a director or manager or his relative is a member or director;

v) a public company in which a director and manager is a director and holds along with his relatives, more than two per cent of its paid-up share capital;

vi) anybody corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;

vii) any person on whose advice, directions or instructions a director or manager is accustomed to act:

Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;

viii) anybody corporate which is-

(A) a holding, subsidiary or an associate company of such company;

(B) a subsidiary of a holding company to which it is also a subsidiary; or

(C) an investing company or the venturer of the company;

Explanation. - For the purpose of this clause, “the investing company or the venturer of a company” means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate.

Exemption - This Clause (viii) shall not apply with respect to section 188 to a private company.

ix) such other person as may be prescribed;

Note: a director (other than an independent director) or key managerial personnel of the holding company or his relative with reference to a company, shall be deemed to be a related party.

Example:

XYZ Pvt. Ltd has two subsidiary companies, Y Pvt. Ltd and Z Pvt. Ltd. Here as per the section 2(76), Y Pvt. Ltd and Z Pvt. Ltd. are related parties. However, as per the Notification No. G.S.R. 464(E) dated 5th June, 2015, clause (viii) shall not apply with respect to section 188 to a private company. Therefore Y Pvt. Ltd and Z Pvt. Ltd are not related parties for the purpose of section 188. However, if Y Pvt. Ltd and Z Pvt. Ltd. have common directors, then they will be deemed to be related parties because of section 2(76)(iv).

Now suppose, XYZ Ltd. a public company, has two subsidiary companies, Y Pvt. Ltd and Z Pvt. Ltd. Here as per section 2(71), a private company which is a subsidiary of a public company will be deemed to be a public company, so Y Pvt. Ltd and Z Pvt. Ltd will not be eligible to avail exemption. Therefore, u/s 2(76), Y Pvt. Ltd and Z Pvt. Ltd are related parties. Also, XYZ Ltd. will also be related Party to Y Pvt. Ltd & Z Pvt. Ltd.

13) Relative, with reference to any person, means anyone who is related to another, if—

i) they are members of a Hindu Undivided Family;

ii) they are husband and wife; or

iii) one person is related to the other in such manner as may be prescribed;

A person shall be deemed to be the relative of another, if he or she is related to another in the following manner, namely: -

(1) Father: Provided that the term "Father" includes step-father.

(2) Mother: Provided that the term "Mother" includes the step-mother.

(3) Son: Provided that the term "Son" includes the step-son.

(4) Son's wife.

(5) Daughter.

(6) Daughter's husband.

(7) Brother: Provided that the term "Brother" includes the step-brother;

(8) Sister: Provided that the term "Sister" includes the step-sister.

14) Total voting power, in relation to any matter, means the total number of votes which may be cast in regard to that matter on a poll at a meeting of a company if all the members thereof or their proxies having a right to vote on that matter are present at the meeting and cast their votes;

15) Turnover means the gross amount of revenue recognised in the profit and loss account from the sale, supply, or distribution of goods or on account of services rendered, or both, by a company during a financial year;

Remaining Relevant definitions will be discussed during the course of syllabus.

ARISE AWAKE AND STOP NOT TILL YOUR GOAL IS ACHIEVED

-Swami Vivekanand

About CA Kishan Kumar

- ★ Kishan Kumar is an **Associate member** of The Institute of Chartered Accountants of India.
- ★ He is a **throughout Rankholder** in CA examinations.
- ★ He himself scored **Exemption in EIS-SM** in his CA Inter Exam..
- ★ He has been **awarded by Nitish Kumar, Hon'ble Chief Minister** of Bihar for his excellence in the field of education.
- ★ Internationally renowned **University of South Wales** has also felicitated him for his aptitude and achievements during his academic life.
- ★ Kishan has worked with **Ernst & Young and PwC (Big 4 Firms)** and uses his practical corporate experience to make the subject more interesting and engaging.
- ★ His students have secured **marks as high as 85** and hundreds have scored exemptions.
- ★ He is committed to make meaningful contribution to the life of promising CA aspirants.

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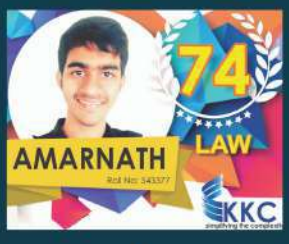

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CHAPTER 1 – PRELIMINARY

UNIT II: NATURE OF COMPANY

The will to succeed is important. But what is more important is the will to prepare.

1. INTRODUCTION

Short Title and Extent [Sec 1]

- This Act may be called the Companies Act, 2013.
- It extends to whole of India.

Statutory Definition [Sec 2(20)]

- As per section (2)(20), Company means a Company incorporated under Companies Act, 2013 or any Companies Act enacted prior to Companies Act, 2013.
- A company is the most dominant (common) from of business organization. It means an association of persons duly registered under the Act, run by professional people (called as Board of Directors). The person who invest the funds in the company are called as members or shareholders.

2. CHARACTERISTICS OF A COMPANY

1) Incorporated association

A Company is a registered/incorporated group of persons. Minimum 7 members are required in case of Public Company and 2 in case of Private Company.

2) Artificial person

A Company is artificial legal person created under the law. Thus, a Company is artificial person but not fictitious.

3) Separate legal entity

Incorporation of a Company makes it a separate legal entity. A Company is legal person entirely distinct and independent from its members. It has its own rights and obligations.

a) Salomon vs. Salomon & Company Ltd. 1897

Mr. Salomon was carrying on a boot manufacturing business as sole proprietor. He sold his business in GBP 39,000 to a Company formed by him along with his wife, a daughter and four sons.

- **Purchase consideration paid by the Company:**

Fully paid shares of GBP 1 issued to Salomon	GBP 20,000
Secured debentures issued to Salomon (secured by a floating charge on Company's assets)	GBP 10,000
Cash	GBP 9,000
Total Consideration	**GBP 39,000**

- One share each of GBP 1 was issued to Salomon's wife, his daughter and his four sons and remaining shares to Mr. Salomon.
- Mr. Salomon was the managing director of the Company and two of his sons were the other directors of the Company.
- The Company almost immediately ran into difficulties and eventually became insolvent and the winding up commenced.

- **At the time of winding up:**

Total assets:	GBP 6,000
Total liabilities:	
Secured debentures (held by Salomon)	GBP 10,000
Unsecured trade creditors	GBP 7,000

- **Claim:**

  The unsecured creditors claimed the whole of Company's assets on ground that Salomon was carrying on business in the name of Salomon & Co. Ltd. and the Company was a mere agent of Salomon.

- **Decision of the Court:**

  The court held that Salomon & Co. Ltd was a real Company fulfilling all the legal requirement. A Company is a legal person distinct from its members and could not be regarded as the agent or trustee of Mr. Salomon.

  Also, the Company's assets must be first applied in payment of secured debentures; as a secured creditor is entitled to payment out of assets on which his debt is secured in priority to unsecured creditors.

b) Lee vs. Lee Air Faming Ltd. Case:

- Lee, a qualified pilot held nearly all the shares in the Company and by its Articles was appointed working director and chief pilot. Lee was killed while piloting Company's aircraft.
- His window claimed compensation under Workmen's Compensation Act. The Company opposed the claim stating that Lee was not the worker as the same person could not be employer and employee.
- **Decision of the court:**

  The court held that Lee was a separate person from the Company he has formed. Thus, there was a valid contract of service between Lee and the Company. As Lee was killed in the course of his employment, his widow was entitled to the compensation.

c) Bacha F. Guzdar vs. Commissioner of income tax case:

- Mrs. Guzdar received dividend income in respect of shares held by her in a Tea Company. Under the Income-tax Act, agricultural income is exempt from income tax. Income of the Tea Company is partly agricultural only 40% of the Company's income is treated as business income; therefore, liable to tax.
- Mrs. Guzdar contented that her divided income should be treated as agricultural income up to 60% on the ground that dividends received by shareholders represented the income of the Company and thus should be exempted from tax in the similar manner.
- **Decision of the court:**

The Supreme Court held that the Company was a separate person from its shareholder having its own business and its own income. The income of the Company was partly agricultural and thus exempted from tax.

But the same income when received by the shareholder is dividend income and could not be regarded as agricultural income and thus tax was payable on the total dividend income.

Implications of the Rule of 'Separate Legal Entity'

a) There can be a transfer of property from a member to the Company and vice versa.
b) A person can be a member, director, employee and creditor of the Company at the same time.
c) A company has the rights and duties of its own.
d) A company is not an agent of members or directors.

4) Capacity to sue and to be sued

A company is a legal person with an independent existence. A Company acts in its own name. Thus, a Company can proceed against the other parties. Similarly, other parties can also file a suit against the Company.

5) Separate ownership and management

The members of a Company do not participate in the day to day affairs of the Company. The Company is managed by elective representatives of the shareholders known as Board of Directors. The directors are appointed as well as removed by the shareholders.

6) Transferability shares

The shares of a Company are transferable in the manner provided in the Articles of the Company. However, in case of Private Company, there are certain restrictions but not prohibition on transfer of shares.

7) Perpetual succession

The term perpetual succession means continued existence. A Company has a perpetual succession. Thus, death, insolvency or insanity of the members does not affect the existence of the Company. Members may come and go but Company continues to exist and the life of the Company does not depend upon the life of its members.

8) Limited liability

The liability of members of a Company is as given below:

S No.	Nature of Company	Extent of liability
1.	Company limited by shares	Amount remaining unpaid on the shares held by the member.
2.	Company limited by guarantee without share capital	Amount guaranteed by the member.
3.	Company limited by guarantee having share capital	Aggregate of the amount remaining unpaid on the shares and the amount guarantee by the member.
4.	Company with unlimited liability	Unlimited i.e., every member has to contribute to the assets of the Company till the entire debt of the Company is paid.

9) Common seal

A Company, being an artificial person, cannot sign a document in the manner a natural person can do. The common seal is a substitute for a signature.

Common seal is required to be affixed only on specified documents like share certificate, share warrants, power of attorney, collaboration, agreement etc. as specified in articles. Common seal affixed on any document binds the Company on the documents.

Common seal has been made **optional** under Companies Amendment Act, 2015.

10) Share capital

The entire capital of the Company is divided into certain specified number of units of equal value and each such unit is called a share.

The concept of share capital enables the investor to participate in the ownership capital of the Company. Thus, share capital enables the Company to mobilize huge capital outlay from lakhs of investors which would not be possible in any other form of business.

3. Is Company a Citizen?

A. Company is not a citizen

Although a Company is regarded as a legal person, it is not a citizen under constitution of India or Citizenship Act, 1955.

B. No fundamental rights available

The constitution provides certain fundamental rights to all citizens. As Company is not citizen, it does not enjoy those fundamental rights which are available to Indian citizens.

However, Constitution of India grants certain fundamental rights to every person, whether a citizen or not. Thus, a Company registered in India can enjoy all the fundamental rights which are available to all the persons.

C. Company has residential status?

Yes, a Company has a residential status which is determined as per provisions of Income-tax Act, 1961.

An Indian Company is always resident in India.

A foreign company ordinarily resides where the effective control and management of its business is exercised.

4. Corporate Veil

A. Meaning

- A Company is formed by the members and managed by the Board of Directors with the assistance of officers and employees.
- On incorporation, law gives separate legal entity to the Company. Thus, a fiction is created by law under which the rights, powers, duties, function, liabilities and property of a Company is differentiated from the rights, power, duties, function, liabilities and property of the employees, member or directors of the Company.
- This fiction of law is called veil of incorporation or corporate veil.

B. Effects of corporate veil

The effect of this corporate veil is that only Company can be held liable for the acts and default done in the name of the Company even though members, directors, officers or employees had acted on behalf of the Company.

C. Lifting of corporate veil

The advantages of corporate veil are allowed to be enjoyed only by those who honestly use the veil of Company for the collective benefit of Company and its members. In case of dishonest and fraudulent use of the facility of incorporation, the law can remove/ lift the corporate veil.

"Lifting of corporate veil" means ignoring the separate legal entity of the Company and looking behind the Company to identify the real persons who control the Company.

Lifting of corporate veil is permissible only if-

- it is permitted by the statute; or
- there is a clear evidence of abuse of the device of incorporation

The court has the discretion whether or not to lift the corporate veil. It is not possible to lay down a specific set of circumstances in which corporate veil may be lifted.

1) JUDICIAL PROVISIONS UNDER WHICH CORPORATE VEIL IS REMOVED

i) Protection of revenue

The court may ignore the separate legal status of a Company where it is **used for tax evasion.**

Decided case law: (Re, Sir Dinshaw Maneckjee petit)

- One person was receiving huge dividend and interest income on some investments and had to pay huge tax.
- He formed 4 private companies and transferred whole of his investments to these 4 companies.
- The dividend and interest received by these companies were within the exempted limits of tax.
- Except these investments, no other business was run by these companies and had no other assets.
- The income received in the form of interests and dividend was transferred to that person in the form of loan and was never returned.
- It was held these companies were created only to evade taxes and therefore court ignored the separate legal entity status of the Company. Hence, whole of interest and dividend earned by the Company was treated as the income of that person.

ii) Determination of enemy character of the Company

A Company may assume an enemy character when persons in **DE-FACTO control of its affairs are residents in any enemy country.**

Decided case law: (Daimler Co. Ltd. vs. Continental Tyre & rubber Co. Ltd.)

- A Company was formed in England for the purpose of selling tyres made by a German Company.
- This German Company held almost all the shares of this new Company formed in England.
- Moreover, all the directors of this Company were German.
- During the First World War, this English Company filed a suit against another English Company for recovery of a debt.
- Court ignored the separate legal identity of the Company and held that the persons who had the ultimate control of the Company were enemies and therefore suit was set aside.

iii) Prevention of fraud

Where a Company is **used for committing frauds or improper conduct,** court may lift corporate veil and look at the realities of the situation.

Decided case law (Gilford Motor Company vs. Horne)

- An employee entered into a contract with his employer not to solicit the customers of the Company after leaving the employment.
- After leaving the employment, he created a Company and started soliciting the customers of the employer.
- It was held that this company was created to avoid the legal obligation arising out of contract.
- Therefore, the employee and the Company created by him were treated as one and thus, the veil between the Company and the person was lifted.

iv) Avoidance of welfare legislation

Where a Company tries to **avoid its legal welfare obligations,** the corporate veil shall be lifted to look at the real picture.

Decided case law: (Workmen of Associated Rubber Industry Ltd. vs. Associated Rubber Industry Ltd)

- A Company was earning huge profits and thus had to pay huge bonus to its employees.
- It created a subsidiary company and transferred some of its investments to it so as to reduce some of its profits.
- This subsidiary company had no other business.
- It was held that this new company was formed just to avoid the liability of the bonus under the Payments of the Bonus Act, 1965.
- Hence, profits earned by the subsidiary company were held as profits of holding company and the holding company had to give bonus on that profits also.

2) STATUTORY PROVISIONS UNDER WHICH THE CORPORATE VEIL IS REMOVED

i) Reduction of membership

Where the number of members fall below statutory minimum and

- Company carries on business **for more than 6 months** while the number is so reduced, then
- every person who is member of the Company at the time the Company so carries on business after 6 months and
- is aware of the fact
- shall be severally liable for payment of whole debts of the Company contracted during that time and may be severally sued therefor.

ii) Misrepresentation in prospectus

In case of misrepresentation in prospectus, every director, promoter and every other person who authorized the issue of such prospectus shall be liable towards those shareholders who subscribed shares on faith of such prospectus.

iii) Failure to refund application money

In case of public issue of shares by a Company,

- if minimum subscription, as stated in the prospectus, has not been received within 30 days of the date of issue or within such time as may be prescribed by SEBI,
- the Company must refund the entire application money within such time as maybe prescribed, else
- the directors of the company who are officers in default shall jointly and severally be liable to repay that money along with interest.

iv) Misdescription of Company's name

Where an officer of a Company signs on behalf of Company on any contract, bill, promissory note, hundi, cheque or orders for money or goods, such person shall be personally liable to the holder if the **name of Company is either not mentioned or is not properly mentioned.**

v) Holding and subsidiary Company

Every holding Company shall attach copies of balance sheet, profit and loss account, director's report and auditor's report etc. of each of its subsidiary company to its balance sheet.

Though holding company and its subsidiary company have separate legal entities, court may treat a subsidiary company as a branch or department of its holding company.

vi) Fraudulent conduct

If on winding up of the Company, it appears to the court that any business of the Company has been carried on with intent to defraud the creditors of the Company or any other person, then the court may declare that any of the directors or officers who are parties to the fraud shall be personally liable.

vii) Liability under other statutes

Besides the Companies Act, the directors and other officers of the Company may be held personally liable under the provisions of other statues.

For example, where any private Company is wound up and if tax arrears of the Company in respect of any income of any previous year cannot be recovered, every person who was director of the Company at any time during the relevant previous year shall be jointly and severally liable for payment taxes.

viii) Ultra-vires act

Director and other officers of Company shall be personally liable for all those acts which they have done on behalf of the Company and which are ultra-vires the Company.

5. Use of Limited and Private Limited

A. Public Limited Company

Every public limited company shall use the words 'Limited (Ltd)' at the end of its name.

B. Private Limited Company

Every private limited company shall use the words 'Private Limited' at the end of its name.

C. Use of the words 'Limited' & 'Pvt. Ltd'

A person can use the words 'Limited' or 'Private Limited' at the end of the name under which he carries on business only if:

i) the association is a Company; and
ii) the Company is limited by shares or guarantee.

D. Punishment for improper use of 'Limited' or 'Private Limited' – For **every** contravention: Minimum INR 500 and maximum INR 2,000.

Note: For Government Companies, suffix "Pvt Ltd/Ltd" is not required.

6. Illegal Association [Sec 464]

A. Meaning of illegal association

Sec 464 of the Companies Act provide that if any association has **more than 50 persons** and is carrying on any business with the **object of acquisition of gain will have to get registered as Company** under the Companies Act, 2013.

An association formed in contravention of sec 464 will be regarded as an **illegal association.**

B. Test of illegal association

The sole test to determine an illegal association is whether it carries on business for the purpose of gain.

C. Non –applicability to Section 404

i) **Associations which are not formed for the purpose of gains** are excluded from the scope of this section like charitable, religious or scientific organizations.

ii) **Association of professionals:** This section also does not apply to association or partnership which is formed by professionals (such as CA, CS, CMA etc.) who are governed by special Acts.

iii) **HUF:** This section does not apply to a Hindu Undivided Family business.

However, where two or more such families form partnership, they will come within the scope of this section. While counting the number of persons, the minor members of such families will be excluded.

D. Karta's entering into partnership in individual capacity

If the kartas of 2 HUF's form a partnership to carry on business for the acquisition of gain and their families together consists more than 50 adult members, the partnership shall be treated as legal as it consists of only two partners.

When the karta of HUF enters into partnership with outsiders in business, the other members of such family do not ipso facto become partners.

E. Effect of non- registration of an association

i) Such association is illegal and has no existence in the eye of law.

ii) The law does not recognize it. Hence, no relief can be granted either to the association or to any of its members as the contractual relationship on which it is founded is illegal.

iii) Once such association is classified as illegal association, subsequent reduction of number of members below 50 has no impact on status of the association i.e. it remains illegal. Thus, once illegal, always illegal.

7. Body Corporate or Corporation

Body Corporate – General meaning

Generally, the term body corporate or corporation means an association of persons having the following characteristics:

a) It is incorporated under any law for the time being in force.
b) It has a separate legal identity.
c) It has perpetual succession.
d) It has the capacity to sue and own property in its own name, and similarly it can be sued in its own name.

Definition of 'body corporate' [sec. 2(11)]

'Body corporate' or 'corporation' includes a company incorporated outside India, but does not include-

a) A Co-operative Society registered under any law relating to Co-operative Societies; and
b) Any other body corporate (not being a company as defined in this Act), which CG may, by notification, specify in this behalf.

8. Key Managerial Personnel [Section 2(51)]

Key Managerial Personnel, in relation to a company, means—

i) the Chief Executive Officer or the managing director or the manager;
ii) the company secretary;
iii) the whole-time director;
iv) the Chief Financial Officer; and
v) such other officer, not more than one level below the directors who is in whole- time employment, designated as key managerial personnel by the Board; and
vi) such other officer as may be prescribed.

ARISE AWAKE AND STOP NOT TILL YOUR GOAL IS ACHIEVED

-Swami Vivekanand

About CA Kishan Kumar

- ★ Kishan Kumar is an **Associate member** of The Institute of Chartered Accountants of India.
- ★ He is a **throughout Rankholder** in CA examinations.
- ★ He himself scored **Exemption in EIS-SM** in his CA Inter Exam..
- ★ He has been **awarded by Nitish Kumar, Hon'ble Chief Minister** of Bihar for his excellence in the field of education.
- ★ Internationally renowned **University of South Wales** has also felicitated him for his aptitude and achievements during his academic life.
- ★ Kishan has worked with **Ernst & Young and PwC (Big 4 Firms)** and uses his practical corporate experience to make the subject more interesting and engaging.
- ★ His students have secured **marks as high as 85** and hundreds have scored exemptions.
- ★ He is committed to make meaningful contribution to the life of promising CA aspirants.

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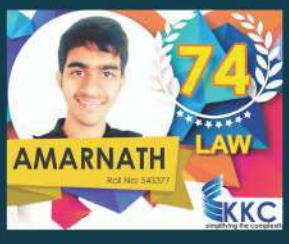

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CHAPTER 2
INCORPORATION OF COMPANY & MATTERS INCIDENTAL THERETO
UNIT I - KINDS OF COMPANY

Believe you can and you're halfway there.

1. CLASSIFICATION OF COMPANIES ON THE BASIS OF LIABILITY

a) Company limited by shares

It is a Company where the liability of its members is limited by memorandum of association to the amount unpaid by them on the shares held by them.

The liability of the members shall arise when a **valid call** is made by the Company during its lifetime or in the event of **winding up.**

b) Company limited by guarantee without share capital

It is a Company where the liability of its members is limited by memorandum of association to the amount that they have guaranteed to contribute:

- **to the assets** of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the **debts and liabilities** of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and
- to the costs, charges and **expenses of winding-up;** and
- for adjustment of the rights of the **contributories** among themselves;

The liability to pay the guaranteed amount shall arise only in event of **winding up** of the Company.

c) Company limited by guarantee having share capital

It is a Company where the liability of its members is limited to the amount which they have guaranteed to contribute in the event of winding up of the Company **plus** any amount remaining unpaid on shares held by them.

The Articles of such Company must state the maximum number of members with which it is registered.

Such companies are usually non-profit concerns made for the promotion of art, science, culture or other charitable purposes.

The **guaranteed amount cannot be called before liquidation.**

d) Company with unlimited liability

It is Company where the memorandum of association of the Company does not limit the liability of its members.

In an unlimited Company, every member is liable to contribute to the assets of the Company until all the debts of the Company are paid in full.

2. Classification of Companies on the basis of Membership

A. Meaning of Public Company [Sec 2(71)]

A public company means a company which

a) is not a private company; **and**
b) has a minimum paid up capital as may be prescribed;
c) is a private company which is subsidiary of a public company.

Note: The requirement of having a minimum paid up share capital shall not apply to a section 8 company.

Note: Since nothing has been prescribed so far. Thus, there is no minimum paid up share capital to form a public company.

B. Meaning of Private Company [Sec 2(68)]

A private company means a company which has

- a minimum paid-up capital as may be prescribed and
- must contain following **restrictions, limitations and prohibitions** in its article of association.

Note: The requirement of having a minimum paid up share capital shall not apply to a section 8 company.

Note: Since nothing has been prescribed so far. Thus, there is no minimum paid up share capital to form a public company.

A private company may be-

a) One -person company [Sec. 2(62)]
b) Small company [Sec. 2(85)]
c) Other than 'One -Person Company' and 'Small Company'.

i) Restriction on the right to transfer its shares

The articles must contain provisions restricting the right of members to transfer its shares freely. The right of transfer may be restricted in the following manner:

a) By authorizing the directors to refuse transfer of shares to persons whom they do not approve.

b) By compelling the shareholders to offer his shareholding to the existing shareholders first.

c) By specifying the method for calculating the price at which the shares may be sold by one member to another. Usually it is determined either by the auditor of the Company or by the Company at a general meeting.

d) By providing that the shareholders who are employees of the Company shall offer the shares to specified persons or class of persons when they leave the Company's service.

However, the articles **cannot impose prohibition** on transferability of shares i.e. there cannot be a complete ban on transfer of shares.

ii) Limitation of membership

The articles must contain a provision whereby the Company (expect in a case of OPC) limits the numbers of its members to 200.

The following persons are **not considered** in counting the number of members:

a) Joint holders of shares shall be counted as one member only.

b) Persons who are in employment of the Company.

c) Ex-employees of the Company who have become members while in employment of the Company and have continued to be members even after termination of employment.

iii) Prohibition on making an invitation to public and accepting deposits

The Articles must prohibit the Company from making any **invitation to the public to subscribe for any of its shares or debentures.**

Similarly, the Articles must prohibit the Company from **inviting or accepting any deposits from public.**

However, the Company is permitted to accept deposits and offer shares or debentures to its members, directors & their relatives.

Membership of Private Company

- At least two persons are required to form a private company. Thus, two or more persons are required to subscribe their names to the memorandum of association of the Company.

2.1. Distinction Between Public and Private Company

Basis	Public Company	Private Company
Minimum no. of members	7 members	2 members
Maximum no. of members	Unlimited	200 members
Public deposits	Free to accept public deposits.	Can accept deposits only from its members, directors and their relatives.
Transferability of shares	Freely transferable.	Restricted but not prohibited.
Public issue	Can issue prospectus to invite general public to subscribe to its shares, debenture and deposits.	Cannot issue prospectus.
Minimum no. of directors	3 directors.	2 directors.
Directors consent	Directors shall file with ROC, their written consent to act as directors.	No such consent required.
Increase in no. of directors	Where the no. of directors is more than 15, Special Resolution is required to be passed.	No. of directors may be increased without permission of the Central Government.

2.2. One Person Company ("OPC") [Sec 2(62)]

OPC means a company which has only one person as a member. It is basically a private company with some unique features. Except for the specific provisions applicable to OPC, all the provisions of the Act and the Rules are applicable to a 'private company', shall equally apply to OPC.

The words "One Person Company" or "OPC" shall be mentioned in brackets below the name of such Company wherever its name printed, affixed or engraved.

A. Logic and advantage of new concept of OPC

i) To encourage unorganized proprietorship business to enter into organized world, the concept of OPC was recommended by JJ Irani committee.

ii) The concept is widely accepted in countries like China, Singapore and US. In case of India, if you wish to set up a private company, minimum 2 shareholders are required. In many cases, because of this legal requirement, a second shareholder is forcefully roped in who, at times, takes advantage of his position. Having recognized this problem, the concept of OPC has been introduced.

iii) The concept of OPC provides a more flexible structure and less compliance requirements of a Company.

B. Who can be a member/ nominee of an OPC

It may be noted that only a **natural person** who is an **Indian citizen** and **resident in India**

- shall be eligible to incorporate a OPC.
- shall be nominee for the sole member of OPC.

Here, the term **resident in India** means a person who has stayed in India for **at least one hundred and eighty-two days or more** during the immediately **preceding financial year.**

Note:

i) A natural person shall not be a member of more than a OPC at any point of time and the said person shall not be a nominee of more than a OPC.

Where a natural person being member in OPC becomes member in another such company by virtue of his being a nominee in that OPC, such person shall meet the eligibility criteria (as given in point above) within a period of 182 days.

ii) No minor shall become member or nominee of the OPC.

Example: Rajesh has formed a 'One Person Company (OPC)' with his wife Roopali as nominee. For the last two years, his wife Roopali is suffering from terminal illness and due to this hard fact he wants to change her as nominee. He has a trusted and experienced friend Ramnivas who could be made nominee or his (Rajesh) son Rakshak who is of seventeen years of age. In the instant case, Rajesh can appoint his friend Ramnivas as nominee in his OPC and not Rakshak because Rakshak is a minor.

C. Nomination by the subscriber or member of OPC

The subscriber to the memorandum of an OPC shall nominate a person, after obtaining prior written consent of such person, who shall, in the event of subscriber's death or his incapacity to contract, become the member of the OPC.

The name of the person nominated shall be mentioned in the memorandum of OPC. Such nomination in Form No INC. 2 along the consent of such nominee obtained in Form No.3 and fee, as provided in the Company's Registration Offices and Fees Rules, 2014, shall be filed with the register at the time of incorporation of the Company along with its memorandum and articles.

D. Withdrawal of consent by nominee

i) The person nominated by the subscriber or member of an OPC may withdraw his consent by giving a notice in writing to such sole member and to the OPC.

ii) The sole member shall nominate another person as nominee within 15 days of the receipt of the notice of withdrawal. He shall send an intimation of such nomination in writing to the Company, along with the written consent of such other person so nominated in form no. INC 3.

iii) The Company shall file the intimation of the name of another person nominated by the sole member in Form No. 4 along with the fees and written consent of such nominated person in Form No. INC 3 within 30 days of receipt of the notice of withdrawal of consent.

E. Change of nominee by sole member

i) The subscriber or member of a OPC may, by intimation in writing to the Company, change the name of the person nominated by him, any time for any reason including in case of death or incapacity to contract of nominee, and nominate another person after obtaining the prior consent of such another person.

ii) The Company shall file with the register, a notice of such change in Form no. INC 4 along with fee as provided and with the written consent of the new nominee in Form no. INC 3 within 30 days of receipt of intimation of the change.

F. Death of sole member

i) Where the sole member of OPC ceases to be the member in the event of death or incapacity to contract, his nominee becomes the member of such OPC.

ii) Such new member shall nominate within 15 days of becoming member.

iii) The person, who shall in the event of death of sole owner or his incapacity to contract become the member of such Company, and the Company shall file with the register an intimation of such cessation and nomination in form no INC 4 along with the fee as provided within 30 days of the change in membership and with the prior written consent of the person so nominated in form no. INC 4.

Note: Provided also that any such change in the name of the person shall not be deemed to be an alteration of the memorandum.

G. Privileges to an OPC

Because much public interest is not involved, many relaxations have been granted to OPC in compliances and procedural aspect. Some of salient features of OPC and the privileges are as follows:

i) An OPC is primarily a private company. However, it requires only one person (as against 2 in the case of private company).

ii) OPC is not required to hold annual general meeting.

iii) Financial statement, with respect to One Person Company, small company, dormant company and private company (if such a company is a start-up) may not include the cash flow statement.

iv) Information to be provided in the director's report has been significantly reduced (as compared to a private company).

v) Annual return in other companies shall be signed by director and Company secretary. However, in case of OPC, annual return shall be signed by Company Secretary and in case of his absence, it will be signed by director of the Company.

vi) The requirement of a minimum no. of board meetings to be convened shall not apply to an OPC having one director. However, in case of OPC having more than 1 director, the OPC shall hold at least one meeting of Board of Directors in each half of calendar year and the gap between 2 meetings shall not be less than ninety days.

H. Prohibitions on OPC

i) OPC cannot be incorporated or converted into a Company under section 8 of the Act.

ii) OPC cannot carry out non-banking financial investment activities.

iii) OPC cannot invest in securities of a body corporate.

iv) OPC cannot be converted into any kind of Company unless 2 years have expired from the date of incorporation.

I. Compulsory Conversion

OPC shall cease to be entitled to continue as OPC if:

a) its paid-up share capital is increased beyond INR 50,00,000/- **or**

b) its average turnover (preceding 3 years) exceeds 2 Crores.

Within 6 months, such OPC shall be required to convert itself, in accordance with the provisions of sec. 18 into-

i) a private company with a minimum of 2 members and 2 directors; or

ii) a public company with at least 7 members and 3 directors

Example: Abha formed a 'One Person Company (OPC)' on 15th October, 2017 with her husband Akhil as nominee and Rs. 10 lacs as Authorised and paid-up share capital. In the month of April,2018 she got in touch with a foreigner and is expecting to receive a substantial export order by May, 2018 whose final delivery must be completed by December, 2018. She is contemplating to convert her OPC into a private limited company before she

receives the export order in May 2018. In this case, Abha cannot voluntarily convert her OPC into a private limited company before expiry of two years from 15-10-2017 i.e. upto 14th October, 2019.

2.3. SMALL COMPANY [SEC 2(85)]

A. Meaning

Small Company means a Company, other than a Public Company satisfying **both** of the following conditions:

i) ***Paid-up share capital*** of which ***does not exceed INR 50 lakhs*** or such higher amount as may be prescribed. The prescribed amount shall not be more than INR *10 crore rupees*; and

ii) **Turnover** of which, as per profit and loss account for the immediately preceding financial year, **does not exceed INR 2 crore rupees** or such higher amount as may be prescribed. The prescribed amount shall not be more than INR *100 crore rupees*.

Following companies shall not be treated as Small Companies

- A public company
- A holding or a subsidiary company;
- A company registered under section 8 (companies formed for charitable purpose); or
- A company or body corporate governed by any special Act

Example

P Ltd. is a company registered under the Companies Act, 2013 with paid up capital of INR 10 Lacs and turnover INR 2 crore rupees. According to section 2(85) a small company is a company other than a public company with the paid up of capital not exceeding fifty lakh rupees and turnover not exceeding two crore rupees. Since, P Ltd. is a public company though complying with other requirements, it cannot avail the status of a small company.

B. Logic and advantage of new concept of Small Company

i) The Companies Act, 2013 provides for a new entity in the form of Small Company, empowering the Central Government to provide for a simpler compliance regime for small companies.

ii) Because of their size, they cannot be burdened with the same level of compliance requirement as the large public listed companies.

C. Some of the important relaxations of Small Company

i) Financial statement of small company may not include the cash flow statement.

ii) Small company shall be deemed to have complied with the provisions relating to board meeting if at least one meeting of the Board of Directors has been conducted in each half of a calendar year and the gap between the 2 meetings is not less than ninety days.

iii) Merger or amalgamation between two or more small companies has been simplified without the requirement of court process.

3. ON THE BASIS OF CONTROL

A. Holding Company [Sec 2(46)]

Holding Company, in relation to one or more other companies, means a company of which such companies are subsidiary companies.

A company shall be deemed to be a holding company of another only if the other is its subsidiary.

Note: For the purposes of this clause, the expression "company" includes anybody corporate.

B. Subsidiary Company [Sec 2(87)]

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 voting power**, either on its own or together with one or more of its subsidiary companies.

Explanation

i) A Company shall be deemed to be a subsidiary company of the holding company even if the control referred to in points above is of another subsidiary company of the holding company.

ii) 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 at its discretion, can appoint or remove all or a majority of the directors.

3.1. Restrictions on layers

'Layer' in relation to a holding company means its subsidiary or subsidiaries.

As per Companies (Restriction on Number of Layers) Rules, 2017, no company shall have more than 2 layers of subsidiaries.

For the purpose of computing the number of layers, one layers which consists of one or more wholly owned subsidiary or subsidiaries shall not be considered.

However, this restriction shall not affect a company from acquiring a company incorporated outside India with subsidiaries beyond 2 layers as per the laws of such country.

3.1.1. Non -applicability of the Rules

Nothing contained in these Rules shall apply to the following classes of Companies

a) A banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949.
b) A Non-Banking Financial Company.
c) An insurance Company
d) A Government Company referred to in clause (45) of section 2 of the Act.

C. Associate Company [Section 2(6)]

Refers to a Company in which that other Company has a significant influence but which is not a subsidiary company of the Company and includes a Joint Venture Company.

The term 'Significant influence' used in the definition means control of at least 20% of total voting power, or control of or participation in business decisions under an agreement.

Note: Shares held by a Company in another Company in a 'Fiduciary capacity' shall not be counted for the purpose of determining relationship of Associate Company.

D. Joint Venture

A joint arrangement where parties that have joint control of arrangement have rights to net assets of arrangement.

4. Subsidiary Company Cannot Hold Shares of its Holding Company [Sec 19]

General Law: A subsidiary company cannot be member of its holding company, directly or through its nominee. Any allotment or transfer of shares by a company to subsidiary company shall be **void.**

Exceptions

A subsidiary company can become the member of its holding company and can vote in its meeting

a) Where the subsidiary is holding shares **in the capacity of legal representative of a deceased member** of the holding company.

b) Where the subsidiary is holding shares **as a trustee.**

A subsidiary company can become the members of its holding company but cannot vote in its meeting if subsidiary company was the member of holding company

a) Before becoming the subsidiary of that Company.

Such companies can continue to be a member of its holding company.

Example: RPIP Ltd. has invested 51% in the shares of SSP Pvt. Ltd. on 31 March 2017. SSP Pvt. Ltd. have been holding 2% equity of RPIP Ltd since 2011. SSP Pvt. Ltd. cannot increase its equity beyond that 2% on or after 31 March 2017. However, it could continue to hold or reduce its initial 2% stake.

5. On the basis of Access To Capital

A. Listed Company [Sec 2(52)]

A Company which has any of its securities listed on any recognized stock exchange.

B. Unlisted Company

Unlisted Company means a company other than listed company.

6. Formation of Companies with Charitable Objects, etc. [Sec 8]

Registration of a non-profit organization as a company

A person or an association of persons may be registered under section 8 of this Act as a limited company if the following conditions are satisfied:

i) Object

Its object is the promotion of commerce, arts, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object.

ii) Application of profits

It intends to apply its profits, if any, or other income in promoting its objects.

iii) Prohibition on payment of dividend

It intends to prohibit the payment of any dividend to its members etc.

If above conditions are satisfied, then the CG may grant the Company a license to be registered as a Company u/s 8. CG has currently delegated the power to ROC. But if the CG feels fit, he may revoke the delegation in public interest.

iv) Conversion of a company into a company u/s 8

Where CG is satisfied that a limited company was formed under the Companies Act, 2013 or under any previous company law, otherwise than u/s 8; and

- such company fulfils all the conditions required for formation of a Company u/s 8,
- it may, by issue of a license in the prescribed manner;
- allow such Company to be registered u/s 8; and
- allow such company to alter its name by omitting the words 'Limited' or 'Private' Limited

Upon issue of such a license by CG, the registrar shall, on an application made to him in the prescribed form, register such company u/s 8.

On registration of the company u/s 8, all the provisions of sec. 8 shall apply to such company. The company shall have to comply will such additional conditions as may be contained in the license issued by CG.

Note: The power of Central Government to register a Section 8 company has been delegated to ROC. Under the said notification, the Central Government has delegated to the Registrar of Companies, the power and functions vested in it under the said section of the said Act.

Central Government may revoke such delegation of powers or may itself exercise the powers and functions under the said sections, if in its opinion, such a course of action is necessary in the public interest.

OTHER POINTS

a) No use of words 'Limited' or 'Pvt. Ltd.'

CG may allow that a Company registered under section 8 may not add to its name, the words 'Limited' or 'Private Limited', as the case may be.

b) Same privileges and obligations as a limited company

The Company registered under this section shall enjoy all the privileges and be subject to all the obligations of the limited companies.

c) Firm can also become its member

A firm may be a member of the Company registered under this section.

d) No alteration in MOA & AOA without the prior approval of CG

A Company registered under this section shall not alter the provisions of its memorandum or articles except with the **previous approval of the CG.**

e) Amalgamation with any other company

A company registered u/s 8 shall amalgamate only with any order company registered u/s 8 and having **similar objects.**

f) Conversion into any another Company allowed after satisfying the conditions

A Company registered under this section may convert itself into Company of any other kind only after complying with such conditions as may be prescribed.

g) Exceptions/Relief

i) Can call its general meeting by giving a **clear 14 days' notice** instead of 21 days.
ii) Requirement of minimum number of directors, independent directors etc. does not apply.
iii) Need not constitute Nomination and Remuneration Committee and Shareholders' Relationship Committee.
iv) The requirement of having a minimum paid up share capital shall not apply to a section 8 company.

REVOCATION OF LICENSE BY CENTRAL GOVERNMENT

The CG may revoke the license granted to this kind of a Company if

i) the Company contravenes any of the provisions of section 8; or
ii) the Company contravenes any conditions subject to which the license was issued; or
iii) the affairs of the Company are carried on fraudulently or violative of its objects or prejudicial to public interest.

Before revocation of license, Central Government must give it a **written notice** of its intention to revoke the licence and **opportunity to be heard** in the matter.

Consequence of Revocation of License

i) Addition of words 'Limited' or (P) Ltd/ *Convert its status* and *change its name*

On revocations of license, CG shall direct the Company to *convert its status* and *change its name* to add the word 'Limited' or the words 'Private Limited'.

ii) Winding up of Company

Where a licence is revoked, the Central Government may, by order, if it is satisfied that it is essential in the public interest, direct that the company be wound up under this Act.

Use of surplus assets on winding up

Where any assets of the company remain after the payment of all the debts and liabilities in case of winding up and dissolution of the company then such assets shall be:

a) transferred to any other company registered u/s 8 and having similar objects (subject to such conditions as the tribunal may impose); or

b) sold, and proceeds of the sale shall be credited to Insolvency and Bankruptcy Fund formed u/s 224 of the Insolvency and Bankruptcy Code, 2016.

iii) Amalgamation with another section 8 company having similar objects

Where a licence is revoked, the Central Government may, by order, if it is satisfied that it is essential in the public interest, direct that the company be amalgamated with another company registered under this section having similar objects.

iv) The company shall file with the registrar a copy of the order of CG.

Tribunal" means the National Company Law Tribunal (NCLT) constituted under section 408 of the Companies Act, 2013. The NCLT is a quasi- judicial body in India that adjudicates issues relating to companies in India. The NCLT was established under the Companies Act, 2013 and was constituted on 1st June, 2016.

Penalty/ punishment in contravention:

If a company makes any default in complying with any of the requirements laid down in this section,

a) the company shall, be punishable with fine varying from ten lakh rupees to one crore rupees and

b) the directors 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 varying from twenty-five thousand rupees to twenty-five lakh rupees, or with both.

Where it is proved that the affairs of the company were conducted fraudulently, every officer in default shall be liable for action under section 447.

7. Other Companies

7.1. Dormant Company

A. Definition

Where Company is formed and 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 in such manner as may be prescribed, for obtaining the status of a Dormant Company.

B. Meaning of inactive company

Inactive company means-

i) A company which has not been carrying or any business or operations; or

ii) A company which has not made any significant accounting transaction during the last 2 financial years; or

iii) A company which has not filed financial statement and annual returns during the last 2 financial years.

C. Significant accounting transaction

Significant accounting transaction means any transaction other than

i) Payment of fees by a Company to the registrar.

ii) Payments made by it to fulfill the requirements of this Act or any other law.

iii) Allotment of shares to fulfill the requirements to this Act.

iv) Payments for maintenance of its office and records.

D. Significance for Dormant Company

- This concept was not there in Companies Act, 1956. Another name of this concept by professionals is "Asset Shielding Company" under Companies Act, 2013.
- A dormant company offers excellent advantage to the promoters who want to hold an asset or intellectual property under the corporate shield for its usage at a later stage.

  For instance; if a promoter wants to buy lands now for its future project at a comparatively lesser price, he may do the same through dormant company.
- A dormant company may be either a public company or a private company or a OPC.
- **Note:** The Financial statement of a dormant company may not include the cash flow statement;

7.2. Public Financial Institution

"Public Financial Institution" means,

a) The Life Insurance Corporation of India

b) The Infrastructure Development Finance Company Limited

c) Unit Trust of India

d) Institutions notified by Central Government under sub section (2) of section 4A of the Companies Act, 1956.

e) Such other institution as may be notified by the Central Government in consultation with the Reserve Bank of India.

Provided that no institution shall be so notified unless—

a) it has been established or constituted by or under any Central or State Act other than this Act or the previous company law or

b) not less than 51% of the paid-up share capital is held or controlled by the CG or by any SG or Governments or partly by the CG and partly by one or more SG;

7.3. Foreign Company

Foreign company means any company or body corporate incorporated outside India which

a) has a place of business in India; whether by itself or through an agent, physically or through electronic mode;

b) conducts any business activity in India in any other manner.

7.4. Government Company

A government company is a company in which not less than 51% of the paid-up share capital is held by:

a) Central Government

b) Any State Government

c) Jointly by Central Government and any State Government(s).

Note: Subsidiary of a Government Company is also a Government company.

Note: For Government Companies, suffix "Pvt. Ltd/Ltd." not required. This exception shall be applicable to a government company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar.

Example: X is a company in which 50% of shareholding is held by Central Government. Here X is not a government company as there is no compliance of minimum holding of paid-up share capital i.e. at least 51 % by the Central Government, or by any State Government or Governments.

Example 6: X Industries Ltd. is a company in which 25% of shareholding is held by Central Government; 10% shareholding is held by Government of Maharashtra and 15% shareholding is held by Central Government and Government of Rajasthan. Here, X Industries Ltd. is not a government company as there is no compliance of minimum holding of paid-up share capital i.e. at least 51 % by the Central Government, or by any State Government or Governments or partly by the Central Government and partly by one or more State Government.

ARISE AWAKE AND STOP NOT TILL YOUR GOAL IS ACHIEVED

-Swami Vivekanand

About CA Kishan Kumar

- ★ Kishan Kumar is an **Associate member** of The Institute of Chartered Accountants of India.
- ★ He is a **throughout Rankholder** in CA examinations.
- ★ He himself scored **Exemption in EIS-SM** in his CA Inter Exam..
- ★ He has been **awarded by Nitish Kumar, Hon'ble Chief Minister** of Bihar for his excellence in the field of education.
- ★ Internationally renowned **University of South Wales** has also felicitated him for his aptitude and achievements during his academic life.
- ★ Kishan has worked with **Ernst & Young and PwC (Big 4 Firms)** and uses his practical corporate experience to make the subject more interesting and engaging.
- ★ His students have secured **marks as high as 85** and hundreds have scored exemptions.
- ★ He is committed to make meaningful contribution to the life of promising CA aspirants.

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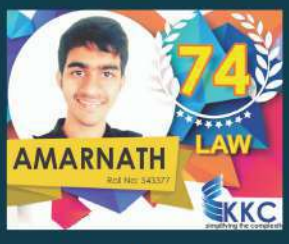

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CHAPTER 2
INCORPORATION OF COMPANY & MATTERS INCIDENTAL THERETO
UNIT III – MEMORANDUM & ARTICLES

Try not to become just a man of success, but rather try to become a man of value.

1. DEFINITION, MEANING & PURPOSE OF MEMORANDUM OF ASSOCIATION

A. Definition [Sec 2(56)]

Memorandum means

- "Memorandum of association of a company"
- as originally framed or altered from time to time
- in pursuance of any previous companies' law or of this Act.

B. Meaning

Following meaning is drawn from definitions by Palmer, Bowen, and Lord Cairns

- It is the charter of a Company.
- It contains the objects for which the Company is incorporated.
- It defines the possible scope of operations of the Company.
- It defines the power as well as limitations on the power of a Company.
- It contains fundamental conditions upon which alone a Company is allowed to be incorporated.

Note: No company can be registered without a memorandum. It is one of the key document that is required to be filed at the time of registration of Company.

C. Purpose

i) For third parties

To provide information to the third parties as to whether the contacts they are intending to enter into with the company are **within the object clause** of the company or not.

ii) For shareholders

To provide information to the intending shareholders regarding the **purpose** for which his money is going to be used by the company and the amount of **risk he is making** in the investment.

2. Memorandum - Contents, Requirements and Tables [Sec 4]

A. Contents of Memorandum

Following are the clauses/ conditions of memorandum

i) Name clause
ii) Situation clause
iii) Object clause
iv) Liability clause
v) Capital clause (only in case of Company having share capital)
vi) Subscription clause
vii) Nomination/ Succession clause (only in case of OPC)

B. Requirements for memorandum

The memorandum shall be

i) Printed,
ii) Divided into paragraphs and numbered consecutively,
iii) Signed by each subscriber who shall add his address, description and occupation, if any
iv) The signature shall be made in the presence of at least one witness who shall attest the signature.

3. Name Clause of MOA

A. Distinct name to have distinct identity

i) A company being a distinct legal entity must have a name of its own to establish its separate identity.

ii) The promoters have to get the name of the company approved by the ROC by filing an application with the ROC.

B. Application for reservation of name

a) Any person may make an application to the registrar for reservation of name in such form (Form INC-1) and in such manner as may be prescribed. The application shall be accompanied with prescribed fees.

b) The application may be made-
   i) for reservation of name for a company proposed to be incorporated; or
   ii) by a company already in existence, for the purpose of changing its name to a new name, viz, the name proposed to be reserved.

C. Reservation of name by the registrar

On perusal of the application for reservation of name and the information and documents furnished along with the application, the registrar may reserve the name for a period of

- **In case of a New Company -** 20 days from the date of approval.
- **In case of an existing Company -** 60 days from the date of approval.

D. Cancelling name:

Where after reservation of name, it is found that name was applied by furnishing wrong or incorrect information, then:

i) if the company has not been incorporated, the reserved name shall be cancelled and the person who has made the application shall be liable to a penalty which may extend to one lakh rupees;

ii) if the company has been incorporated, the Registrar may, after giving the company an opportunity of being heard—

(1) either direct the company to change its name within a period of 3 months, after passing an ordinary resolution;

(2) take action for striking off the name of the company from the register of companies; or

(3) make a petition for winding up of the company.

E. Name should not be undesirable

A company cannot be registered by any of the following names:

i) Names which resemble too nearly with name of existing company, viz. [Rule 8]

ii) Undesirable name [Rule 8A]

iii) Word or expression which can be used only after obtaining previous approval of CG. [Rule 8B]

i) A name is to be undesirable if

a) it is prohibited under the provisions of section 3 of the Emblems and Names (Prevention and Improper Use) Act, 1950 (12 of 1950), unless a previous permission has been obtained under that Act; or

b) the proposed name is identical with or too nearly resembles the name of a limited liability partnership or with a name which is for the time being reserved in accordance with Rule 9

c) Infringes a registered trademark; or

d) A trademark which is subject to an application for registration.

ii) A name may also be undesirable when

a) It contains any word which is unnecessary or fancy or offensive to any section of the people; or

b) The two companies are in some related business; or

c) The circumstances show that the public will be misleading by the new name; or

d) it is identical to the name of a company dissolved as a result of liquidation proceeding and a *period of 2 years has not elapsed* from the date of such dissolution.

Decided case law: Ewing v Buttercup Margarine Co. Ltd.

- The plaintiff was carrying on the business of selling margarine (a selling kind of butter) and tea as a sole trader in the name and style of Buttercup Dairy Company.
- The defendant Co. was registered in the name of Buttercup Margarine Ltd.
- The business of both the plaintiff and the defendant were the same.
- The count granted an injunction restraining the defendant company from using that name, as it was likely to deceive the public or cause confusion to the public.
- The court held that word 'Buttercup Margarine Company Ltd' was undesirable since the word 'Buttercup' was fancy one. It could mislead the public that the Company was associated with the Buttercup Dairy Company'.

F. Use of the word 'Limited' or 'Private Limited'

The name of the company must end with the word Limited or Private Limited; as the case may be (except in the case of Company to be registered under section 8).

G. OPC

An OPC shall mention the words 'One Person Company' in bracket below its name.

H. Guidelines regarding name

i) It should not *Identical with*, or *too nearly resembles* the name of an existing company; or infringes a registered trademark; or a trademark which is subject to an application for registration.

ii) The name should not be such which will deceive or mislead the public.

iii) The name should not be prohibited under the Emblems and Names Act, 1950.

iv) The name should not be similar to the name of a famous person.

v) The name or surname of a person can be used in the name of a company only if such person is a promoter or director of the company, or there is some other justified cause for the time.

vi) The name should not contain 'Co- operative'.

vii) The words 'Bank', 'Banking Investments', 'Insurance Trust' may be used only if use of such words is justified considering the objects and business carried on by the company.

I. Certain words to be used only with the approval of CG [Rule 8B of Companies (Incorporation) Rules, 2014]

The following words and combinations thereof shall not be used in the name of a company in English or any of the languages depicting the same meaning unless the previous approval of CG has been obtained for the use of any such word or expression:

- Board
- Commission
- Authority
- Undertaking
- National
- Union
- Central
- Federal
- Republic
- President
- Rashtrapati
- Small Scale Industries
- Municipal
- Panchayat
- Development Authority
- Minister, Prime Minister or Chief Minister
- Nation
- Statute or Statutory
- Court or Judiciary
- Governor
- Bureau

3.1. Procedure for the change in Name Clause

A. Change in the name (Voluntary Change) [Sec 13]

i) Availability and Reservation of name

The availability of name is to be obtained from ROC by filing an application along with the prescribed fees.

Upon receipt of an application, the Registrar may reserve the name for a period of sixty days from the date of approval or such other period as may be prescribed.

ii) Pass a special resolution

The change in the name has to be approved by the shareholders by passing as **special resolution.**

iii) Approval of CG

The **prior approval** of Central Government[1] is required.

~~***Note:*** *The approval of CG is not required in cases where change is only addition or deletion of word 'Private' consequent upon conversion of private company into public company and vice versa.*~~

iv) Filing of Form MGT. 14 with ROC

Form MGT. 14 should be filed within 30 days together with a copy of the special resolution and the approval of the Central Government with ROC.

B. Rectification of name (Compulsory change) [Sec 16]

In the following cases, CG [2] has power to give directions to rectify its name if a Company has been registered either inadvertently or otherwise with a name which, in the opinion of CG,

i) is identical with, or too nearly resembles the name of an existing company; or
ii) infringes a registered trademark [application to CG should be made within 3 years of incorporation or registration or change of name of the company by the registered proprietor of a trade mark]

i) Procedure for change in case the name is identical with, or too nearly resembles the name of an existing company

a) Ordinary resolution

Company shall obtain approval of members by passing of ordinary resolution in the general meeting.

b) Compliance with CG directions

The Company shall comply with the direction within 3 months of the date of direction by the CG.

ii) Procedure for change in case the name infringes a registered trademark

a) Ordinary resolution

Company shall obtain approval of members by passing of ordinary resolution in the general meeting.

b) Compliance with CG directions

The company shall comply with the direction within 6 months of the date of direction by the CG.

Filing requirements with ROC

Within 15 days of passing an ordinary resolution for rectification of name, the company shall file with the registrar-

i) Notice of rectification of name; and
ii) A copy of the order of CG.

[1] *power delegated by CG to RoC*
[2] *power delegated by CG to Regional Director*

Effect of change in name of the company

i) Where a Company changes its name, it shall give notice to the registrar within 15 days and the registrar shall enter the new name on register in place of the old name and shall issue a fresh certificate of incorporation with the necessary alterations.

ii) The change of name shall be complete and effective only on *issue of fresh certificate of incorporation by the registrar*.

iii) The registrar shall also make the necessary alteration in the memorandum of association of the Company.

No effect after change in the name of the company

The change of name shall

a) not affect any rights or obligations of the company, or

b) not affect any legal proceedings which might have been continued or commenced by or against the Company in its former name. Such legal proceedings may be continued by or against the Company in its new name.

No Change in Name allowed if the Company has committed certain defaults

The change of name shall not be allowed to a company which has

- not filed annual returns or financial statement due for filing with the registrar or
- which has failed to pay or repay matured deposits or debentures or interest thereon.

However, if such default is made good, then the change of name shall be allowed.

4. Registered Office of Company/Situation Clause [Section 12]

A company is considered to be a separate legal entity from the members. Once a company gets incorporated, it is required to maintain a registered office. This is a physical office where the corporation will receive service of legal documents from ROC or in case of a lawsuit, etc.

This address cannot be a P.O. box but must be a physical location where someone is present, to receive service of legal documents during normal business hours. It could be different from a Head Office or Corporate office.

Section 12 of the Companies Act, 2013 seeks to provide for the registered office of the companies for the communication and serving of necessary documents, notices letters etc.

A. Domicile of the company - This clause contains the name of the state in which the registered office of the Company is to be situated.

B. Mandatory to have registered office

The company must have its registered office **within 30 days** of the incorporation of the Company and at all times thereafter.

Note: Registered office can be different from Head Office or corporate office.

C. Verification of registered office

The company shall furnish to the Registrar verification of its registered office within a period of thirty days of its incorporation

D. Significance of Situation Clause

i) Communication by ROC to the company

All communications, notices, circulars and other correspondences to the Company by ROC, Government Agencies or others are to be addressed to its registered office.

ii) Documents and books of the company

All important documents and books of the Company such as annual returns, minutes, books, register of members etc. are kept in the registered office.

iii) Jurisdiction of court

This is also important for determining the jurisdiction of the Court.

E. Labeling of company/ Name, address etc. to be printed on official publications

The following particulars shall be printed on all the business letters, billheads and in all its notices and other official publications:

a) Name of the company
b) Address of its registered office
c) The corporate identity Number
d) Telephone number
e) Fax number, if any
f) E-mail address
g) Website address, if any.

F. Name and address to be painted outside the offices of the company

Every company shall affix its name and the address of its registered offices, and keep the same affixed, on the outside of every office or place in which its business is carried on, in a visible position, in legible letters.

G. Particulars to be published on the Website

Every company which has a website for conducting online business or otherwise shall disclose/publish, on the landing/ home page of the said website, the following particulars:

a) Name of the company
b) Address of its registered office
c) The corporate identity Number
d) Telephone number
e) Fax number, if any
f) E-mail address
g) The name of the person who may be contracted in case of any queries or grievances.

H. Name change by the company:

Where a company has changed its name/s during the **last two years**, it shall **paint** or **affix** or **print**, along with its name, the **former name** or **names so changed** during the last two years.

I. In case of OPC:

The words **"One Person Company"** shall be mentioned **in brackets** below the name of such company, wherever its name is printed, affixed or engraved.

New sub- section 9 inserted.

If the Registrar has reasonable cause to

- believe that the company is not carrying on any business or operations,
- he may cause a physical verification of the registered office of the company and
- if any default is found to be made in complying with the requirements of 12(1) [setting up registered office

within 30 days of incorporation],

- he may without prejudice to the provisions of 12(8) [if default is made in complying with the requirements of this section, the company and every officer who is in default shall be liable to a penalty of one thousand rupees for every day during which the default continues but not exceeding one lakh rupees],
- initiate action for the removal of the name of the company from the register of companies.

4.1. Change of Reistred Office [Sec 12] & Alteration of Situation Clause [Sec 13]

A. Change of registered office (From one place to another within the same city)

Legal procedure

i) Pass Board Resolution in the meeting of directors to this effect.

ii) File Notice of such change to the ROC **within 30 days** of the change in from INC. 22.

iii) No alteration of memorandum of association is required because in MOA only the name of state is mentioned and not the address.

B. Change of registered office (from one town, city or village to another town, city or village within the same state)

Legal procedure

i) Pass Special Resolution in the meeting of members.

ii) Notice of such change is to be given to ROC **within 30 days** of the change in Form INC. 22 along with Form MGT. 14 within 30 days of the passing of special resolution.

iii) No alteration of memorandum of association is required.

C. Change of registered office (From the jurisdiction of one ROC to the jurisdiction of another ROC within the same state)

Legal procedure

i) Special resolution

Pass special resolution in the meeting of members.

ii) Application to Regional Director for his Confirmation

Company shall obtain confirmation from regional director by applying to him in prescribed form.

iii) Communication of confirmation by RD in 30 days

RD shall communicate the confirmation to company within 30 days from the date of receipt of the application.

iv) Company shall file certified copy of confirmation with ROC along with attested MOA

Certified copy of the confirmation along with the attested copy of the memorandum of association must be filed with the ROC for registration within 60 days from the date of confirmation.

Within 30 days of filing, the ROC shall certify registration.

v) Transfer of records by ROC

Registrar of the present jurisdiction shall send all the records and documents related to the company to the registrar of the new jurisdiction in the same state.

vi) Shifting of the address: The company shall shift its registered office.

vii) Notice by company to new registrar

Company shall give *notice of such change* to the ROC *within 30 days* of the change in Form INC 22, **along with** *FORM MGT. 14 within 30 days of passing of special resolution.*

Note: No alteration of memorandum of association is required

D. Change of registered office (From one state to another)

Legal procedure

i) Resolution of the Board of Directors

Company shall pass Board Resolution in the meeting of directors to this effect.

ii) Special resolution

Pass Special Resolution in the meeting of members.

iii) Sanction by CG

Petition to CG

Company shall obtain confirmation of the CG by filing a petition to CG.

Delegation of powers by CG to Regional Director

Notice to affected parties by Regional Director

Before confirming the change, the RD shall ensure that sufficient notice has been given to every person whose interest will be affected by the change and that the consent of the creditors has been obtained or their debts or claims have been discharged or secured.

CG shall dispose of the application within 60 days

The Central Government may make an order confirming the alteration on such terms and conditions, if any, as it thinks fit.

iv) Copy of the order to be filed with ROCs

A certified copy of order confirming the alteration **together with** a printed copy of altered memorandum shall be filed by the company with the registrar of both the states within prescribed time.

v) Transfer of records by ROC

Registrar of the present state shall send all the records and documents related to the Company to the registrar of the other state.

vi) Shifting of the address: The company shall shift its registered office.

vii) Notice by company to new registrar

The Company shall give notice of such change to the ROC within 30 days of the change in form INC. 22 along with FORM MGT.14 within 30 days of passing of special resolution.

Note: Memorandum of association is required to be altered.

5. OBJECT CLAUSE

- **Object of the company**

The object clause should state the objects for which the company is proposed to be incorporated along with any matter considered necessary in furtherance thereof.

- **Act outside Object Clause is void**

Any act which is outside the Objects clause of the Memorandum of Association of the Company is ultra vires and thus void.

- **Any lawful object can be chosen**

The promoters are free to choose any lawful object which the Company may follow after incorporation. The object should not be

i) illegal or
ii) against the public policy.
iii) against the provisions of the Companies Act.
iv) against the general law of land.

5.1. Alteration of Object Clause [Sec 13]

i) Special resolution

Company shall pass special resolution in the meeting of members.

ii) Filing with ROC

Company shall give notice of such change to the ROC along with FORM MGT. 14 within 30 days of passing of special resolution.

iii) Certification by ROC

ROC shall register the same and certify it within 30 days of the date of filing.

Note: The alteration shall be effective only when it has been duly registered by the registrar.

Variation in terms of contract or Objects in Prospectus - To protect Minority Interest [Sec 27]

Once funds are raised through a given prospectus, the principles of "doctrine of ultra vires" (mutatis mutandis) comes into play i.e., the company has to use the funds strictly in accordance with the prospectus.

Hence, restriction has been imposed on the change of object clause of a company which has raised money from public through prospectus and still has any unutilized amount out of money so raised.

Such Company shall not change its object for which it raised the money through prospectus

- unless a special resolution is passed by the company and
- exit option is given to the dissenting shareholders in terms of the regulations prescribed by SEBI and
- prescribed details are published in one English and one vernacular language newspaper which is in circulation at a place where registered office at the company is situated.

The notice of the proposed special resolution shall contain the following particulars, namely:—

a) the original purpose or object of the Issue;
b) the total money raised;
c) the money utilised for the objects of the company stated in the prospectus;
d) the extent of achievement of proposed objects (that is fifty percent, sixty percent, etc.);
e) the unutilised amount out of the money so raised through prospectus,
f) the particulars of the proposed variation in the terms of contracts referred to in the prospectus or objects for which prospectus was issued;
g) the reason and justification for seeking variation;
h) the proposed time limit within which the proposed varied objects would be achieved;

i) the risk factors pertaining to the new objects; and

j) the other relevant information which is necessary for the members to take an informed decision on the proposed resolution.

Note: Such details are also placed on the Company's website indicating justification for change.

Note: Provided further that such company shall not use any amount raised by it through prospectus for buying, trading or otherwise dealing in equity shares of any other listed company.

6. Liability Clause

A. Mandatory for limited company only

Liability clause is mandatory only for a company in which liability of members is limited.

B. Nature of limitation of liability

In case of a limited company, the liability of the members may be limited by shares or guarantee or both.

i) In case of company limited by shares

The liability clause must state that the liability of members is limited by shares. Thus, the liability of the members is limited only to the extent of amount unpaid on shares.

ii) In case of company limited by guarantee only

The liability clause must state that the amount of guarantee that each member has given to contribute—

a) to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and

b) to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves.

Only member have a right to participate in the divisible profits of the company: Any alteration of memorandum, in case of a company limited by guarantee and not having a share capital, intending to give any person a right to participate in the divisible profits of the company otherwise than as a member, shall be void.

iii) In case of company limited by guarantee and having a share capital

The liability clause must state that the liability of the members is limited to the aggregate value of

a) Amount unpaid on shares and

b) Amount of guarantee each member has given.

iv) In case of unlimited company

The clause shall specify that the liability of members is unlimited and can extend to personal assets of the members.

v) In case of One Person Company

The clause covers the name of the person who, in the event of death of the subscriber, shall become the member of the company.

C. Alteration of liability clause

i) Liability of the members cannot be increased.

ii) However, sec.18 permits a company of any class registered under this Act to convert itself in some other class of company by altering its memorandum and articles of association.

By using these provisions, unlimited companies may be converted to a limited company or vice-versa.

7. Capital Clause

A. Non-mandatory for the Companies

i) Limited by guarantee having no share capital.
ii) Unlimited companies having no share capital.

B. Mandatory for Company having share capital

This clause is mandatory only for Company

i) Limited by shares having share capital
ii) Limited by guarantee and having share capital
iii) Unlimited companies having share capital.

C. Contents of capital clause.

The capital clause states

i) The number of shares
ii) The nominal value of each share and
iii) The total capital with which the company is to be registered.

7.1. Alteration of Capital Clause [Section 61]

Please refer section 61 as given in Chapter 13 – Share and Share Capital.

8. Subscription Clause

A. Contents

- It contains the name of the persons who subscribe to memorandum and state that they are willing to form themselves into a company.
- These persons are called subscribers and are the first members of the Company.

B. Legal requirements

There should be at least

- 7 subscribers in case of Public Company and
- 2 subscribers in case of Private Company
- 1 subscriber in case of One-person Company.

Each subscriber shall take at least one share. The number of shares which each subscriber has taken shall be stated opposite to its name.

Particulars of subscriber

The memorandum shall be signed by each subscriber who shall add his address, description and occupation, if any.

C. Effect of subscription clause

i) Subscriber to the memorandum is a member

A subscriber to memorandum shall be deemed to be the member of the company as soon as the company is incorporated.

On incorporation, his name is entered in the register of members.

ii) A subscriber cannot repudiate his liability.

After incorporation, a subscriber cannot withdraw and refuse to take up and pay for the shares subscribed by him, *even on the ground of misrepresentation.*

9. Nomination / Succession Clause

This clause states the name of the person who, in the event of the death of subscriber, shall become the member of the company. This clause is mandatory only in case of OPC.

10. Forms and schedule related to Memorandum

The memorandum of a company shall be in respective forms specified in Tables A, B, C, D and E in Schedule I as may be applicable to such company.

Various forms of Articles have been specified in tables F, G, H, I and J in schedule I, as explained hereunder:

Table A	Memorandum of association of a company limited by shares
Table B	Memorandum of association of a company limited by guarantee and not having a share capital
Table C	Memorandum of association of a company limited by guarantee and having a share capital
Table D	Memorandum of association of an unlimited company and not having share capital
Table E	Memorandum of association of an unlimited company and having share capital
Table F	Articles of a company limited by shares
Table G	Articles of a company limited by guarantee and having a share capital
Table H	Articles of a company limited by guarantee and having no share capital
Table I	Articles of an unlimited company having a share capital
Table J	Articles of an unlimited company having no share capital

11. Articles of Association [Sec 2(5) & 5]

As per section 2(5), Articles means

- "Articles of association of a company"
- as originally framed or altered from time to time
- in pursuance of any previous companies' law or of this Act.

Articles are rules and regulation framed by a Company for its own governance.

Note: Matters as to which the memorandum is silent can be dealt with by the alteration of article.

It shall be

- printed
- divided into paragraphs and consecutively numbered
- signed by each subscriber of the MOA who shall also add his address, description and occupation, if any.

The signatures are to be done in the presence of one witness who shall attest signature and also add his address description and occupation.

Applicability of Model Articles [Sec 5]

a) The articles of a company shall be in such form (viz. Table F, G, H, I and J) as may be applicable to it.

b) A company may adopt, modify or reject all or any of the provisions contained in model Articles applicable to it.

c) Where the registered articles of a company do not exclude or modify the provisions contained in the model articles applicable to it, then, such provisions shall be deemed to be included in the registered Articles and shall apply to such company.

10.1. Entrenchment [Sec 5]

A. Provision for Entrenchment

Articles may contain provisions for entrenchment which means that such provisions may be altered only if procedures more restrictive than applicable in the case of special resolutions is provided and complied with.

B. Manner of making provisions for entrenchment

The provisions for retrenchment may be made in the following ways-

- At the time of formation of a Company; or
- By amending the articles by a **Special Resolution** in case of a **public company**; or
- By amending the articles by **Resolution agreed to by all the members** in case of a **private company.**

C. Notice to registrar

- Where articles contain provisions for entrenchment on formation, the company shall give notice of such provisions in prescribed form along with the prescribed fee to the Registrar within 30 days from the date of formation of the Company.
- In case of existing companies, the same shall be filed in Form No. MGT-14 within the said 30 days with fees.

Example:

If PQR Company subscribes by investing in XYZ, a private company in 10% terms, tomorrow if XYZ private limited approaches any Bank for a loan, the bank officials would read the Articles & would ask to get the consent of PQR Company. Now, if there is no entrenchment provision, then 'XYZ' may, after passing a special resolution remove the minority right and can borrow beyond the limit.

In order to control it, the entrenchment provisions are usually compelled by the minority to make the majority responsible and the minority in these provisions can get incorporated a clause saying that borrowing beyond a particular limit or issuances of shares is to be done only after the requisite consent of minority has been obtained.

Example:

Mr. Tarun promoted an education start up and got it registered as a private limited company. Initially he and his family are holding all shares in the company. In the article of association of Company, it is written that Mr. Tarun will remain director of the company for lifetime. But he has a fear that tomorrow if 75% or more shares in the company are held by non-family members then by passing a special resolution article may be changed and he may be removed from the post of director.

Therefore, it was also written in the article that he can be removed from the post of director only if 95% votes are cast in favour of the resolution. This is entrenchment.

10.2. Alteration of Articles of Association [Sec 14]

Section 14 of the Companies Act, 2013, gives companies the power to alter or add to its Articles.

Matters as to which the memorandum is silent can be dealt with by the alteration of article. The law with respect to alteration of articles is as follows:

Resolution required [sec. 14(1)]

Special Resolution is required for every alteration of articles, including alteration of articles for the purpose of-

a) Conversion of a private company into a public company, and

b) Conversion of a public company into a private company

Conversion of a private company into a public company [1st proviso to sec. 14(1)]

i) A private company may get converted into a public company, by altering its articles (by passing a special resolution) in such a manner that its articles no longer include the restrictions, limitation and prohibitions required to be included in the Articles of a private company as per sec. 2(68).

ii) The conversion shall take **effect from the date of alteration of articles.**

Conversion of a public company into a private company

a) A public company may get converted into a private company by

   i) Altering its Articles (by passing SR) so as to include therein, the restriction, limitation and prohibitions required to be included in the Articles of a private company as per sec. 2(68); and

   ii) Obtaining the approval of the Central Government.

b) For obtaining the approval of the Central Government, the company shall make an application to the ~~Tribunal~~ Central Government.

c) The Central Government may make such order as it may deem fit.

d) Until the approval of the Central Government is obtained, the alteration of Articles shall not have any effect.

Filing of alteration

A copy of the altered Articles along with the copy of the order of the Central Government shall be field with the **Registrar within 15 days**, and the Registrar shall register the same.

Effect of alteration [sec. 14(3)]

Every alteration of articles which is registered by the Registrar shall be as valid as if it were originally contained in the Articles.

Prohibition on Alteration of Articles is Invalid

A Company can alter its article as a matter of right. Any clause prohibiting the Company from altering its articles is invalid. Thus, a company cannot deprive itself of the statutory power to alter its AOA. *[Andrews vs. Gas Meter Co. [1897] 1 Ch. 161].*

Alteration of memorandum or articles to be noted in every copy *[Sec 15]*

Every alteration made in the memorandum or articles of a company shall be noted in every copy of the memorandum or articles, as the case may be

10.3. Limitations on Alteration of Articles

a) It must not be inconsistent with provisions of the Company's Act or the MOA or the order of a Court.

b) It must be bonafide and for the benefit of the Company as a whole.

c) It must not include anything which is illegal or opposed to public policy.

d) It must not cause a breach of contract or a fraud on minority shareholders.

e) It must not increase the liability of the members.

f) It must be approved by CG if alteration has the effect of converting a public company into private company.

Binding force of memorandum and articles

On registration, the memorandum and articles binds the Company and its members. Thus, a memorandum and articles constitute a binding contract between the company and its member.

12. Effects of Memorandum and Articles [Section 10]

A. Members are bound to the Company

On registration of MOA and, it is deemed to be signed by each member of the Company.

The members of the Company are bound to comply with the provisions of memorandum and articles.

A member will be held liable for the breach of any provision contained in these documents. Thus, company may sue its members in case of non-compliance.

Example, a company can recover call in arrear from a member as forcefully as it is recovering loan due.

B. Company is bound to its members

The Company is also bound to the members by the provisions of these documents. The Company will be held liable for any breach. Every member can sue the company for enforcement of these provisions.

Every member can bring an injunction when company is about to commit a breach.

C. The members are not bound inter- se (i.e. in relation to one another)

The members of the Company among themselves are not bound by the provisions of these documents as there is no express contract between the members.

However, a member can sue the other member through the Company and not in his own name.

D. Company and its members are not bound to outsiders

The Company and the members are not bound to outsiders who are not members of the company as there is no privity of contract.

The articles do not confer any contractual rights upon outsiders against the Company or its members.

Thus, an outsider cannot take advantage of any provision contained in these documents and bring an action upon the Company.

E. Binding on the directors of the company

The articles of association of a company define the powers and limitation on powers of directors of a company. Any contravention by the directors may have two effects:

i) Effect on the company

In case the contravention affects the company, the members can take a legal action against the directors. However, the members may ratify the act of directors if they so desire.

But where the breach of powers has resulted in a loss to the Company, the directors are liable to reimburse the Company for any loss so suffered.

ii) Effect on the outsider

In case the contravention affects the outsiders, the directors and the company will remain liable to the outsiders.

13. Difference Between AOA and MOA

Basis	Memorandum of Association	Articles of Association
Meaning	It contains fundamental conditions upon which alone the company is allowed to be incorporated.	These are rules and bylaws for the management of internal affairs of the company.

Basis	Memorandum of Association	Articles of Association
Nature	It is a fundamental document.	It is a document subordinate to the memorandum.
Scope	It defines the power and possible scope of the Company in which company has to operate.	It defines and restricts the power of the directors, officers and employee of the Company.
Content	It should have following content: - a. Name clause b. Situation clause c. Object clause d. Liability clause e. Capital clause f. Subscription clause g. Succession clause	The company may, on its own, include such provisions as it thinks fit.
Alteration	Its alteration is difficult as it generally requires approvals of RD and CG.	It can be amended by passing a special resolution only and is comparatively easier than altering memorandum.
Superior and subordinate	MOA is presumed to be superior to AOA. In case of inconsistency between these two documents, MOA always prevails over AOA.	AOA is subordinate to MOA.
Retrospective amendment	It cannot be amended retrospectively.	It can be amended retrospectively.

14. . COPIES OF MEMORANDUM, ARTICLES, ETC., TO BE GIVEN TO MEMBERS [SECTION 17]

A company shall, on being so requested by a member, send to him

- within seven days of the request and subject to the payment of such fees as may be prescribed,
- a copy of each of the following documents, namely:
  a) the memorandum;
  b) the articles; and
  c) every agreement and every resolution referred to in section 117(1), if and in so far as they have not been embodied in the memorandum or articles.

If a company makes any default in complying with the provisions of this section, the company and every officer of the company who is in default shall be liable for each default, to a penalty of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

15. ACT TO OVERRIDE MEMORANDUM, ARTICLES, ETC. [SECTION 6]

The provisions of this Act shall have overriding effect

- on provisions contained in memorandum or articles or
- in an agreement or in resolution passed by the company in the general meeting or by its board of directors,
- whether they are registered, executed or passed before or after the commencement of this Act.

Any provision contained in any of the above-mentioned document, shall be void, to the extent to which it is inconsistent to the provisions of this Act.

However, if any other section of the Act says that article is superior then we will treat it accordingly.

Example:

Section 47 of the Act deals with voting power of members. And a notification dated 5th June, 2015 says that section 47 is applicable to a private company subject to its Article of Association (AOA). Now if AOA of a private company says that section 47 is not applicable to it then in this case AOA will become superior and section 47 of the Act will not be applicable.

16. Service of Documents [Section 20]

A. Service of documents on the Company or any officer of the Company

Where any document is to be served on

i) the Company; or
ii) any officer of the Company

the documents shall be addressed to

i) the Company; or
ii) any officer of the company.

The documents shall be sent at the registered office of the company by:

i) Registered post; or
ii) Speed post; or
iii) Courier; or
iv) Leaving it at its registered office; or
v) Such electronic or other mode as may be prescribed.

Note: The records of beneficial ownership may be sent by the depository to Company by electronic or other mode.

B. Service of documents to the Registrar or Member

Where any document is to be filed with the Registrar or served to the member, the documents shall be sent by-

i) Registered post; or
ii) Speed post; or
iii) Courier; or
iv) Post; or
v) Delivering at the office of the registrar; or
vi) Such electronic or other mode as may be prescribed.

Note: Where any provision of the Act or the Rules requires that a document shall be served on the registrar by electronic mode only, then such documents shall be served on the registrar by electronic mode only.

Note: A member may request the company to deliver to him any documents by a particular mode. For this purpose, he shall have to pay such fees as may be determined by the Company/members in the AGM.

C) Time consumed in delivery of documents

In case of delivery by post, such service shall be deemed to have been effected:

i) in the case of a **notice of a meeting**, at the expiration of **48 hours** after the letter containing the same is posted;
ii) in **any other case**, at the time at which the letter would be delivered in the **ordinary course of post.**

17. Authentication of Documents, Proceedings and Contracts - Requirement [Sec 21]

Signing

Except as otherwise provided in this Act,

a. a document or proceeding requiring authentication by a Company; or
b. contracts made by or on behalf of a Company,

May be signed by-

- any key managerial personnel; or
- an officer *or employee* of the Company duly authorized by the Board in this behalf.

Common seal not required: Authentication of a documents is not required to be made under the common seal, if any, of the company.

18. Execution of Bills of Exchange etc. [Sec 22]

Negotiable instruments - when binding on Company?

A negotiable instrument shall be deemed to have been made, accepted, drawn or endorsed on behalf of a Company if it is made, accepted, drawn, or endorsed on behalf of the Company by any person acting under its authority, express or implied.

Authorization to execute deeds

A Company may authorised any person as its attorney to execute deeds on its behalf in any place, either in or outside India. Such authorization may be made-

A. If the Company has a common seal

- By writing under the common seal of the Company.

B. If the Company does not have a common seal

- By a director and the company secretary, if Company has a company secretary;
- By 2 directors, if the company does not have a company secretary.

Binding effect of deeds

A deed signed by such an attorney on behalf of the Company and under his seal shall be binding on the company.

19. Doctrine of Ultra Vires

A. Meaning of ultra vires act

The term 'ultra' means 'beyond' and the term 'vires' means 'powers'. Thus, the term 'ultra vires' means doing an act beyond the powers.

B. An act will be ultra vires the Company if

i) it is not permitted or authorized by the Company Act, 2013; or
ii) if it falls outside the object clause of MOA; or
iii) its attainment is not incidental or ancillary to the attainment of main objects.

C. Objective of doctrine of ultra vires

i) To protect the investors of the company

Investors should know the objects in which their money is to be employed.

ii) To protect the creditors

It ensures that the Company's funds which are to be used for making payment to creditors are not used in unauthorized acts.

D. Decided case laws

Ashbury Railway Carriage & Iron Co. Ltd v Riche

i) **The object clause of MOA was like below**

To make, sell or lend or hire railway carriages and wagons/ to carry on the business of mechanical engineers and general contractors.

To purchase lease work and sell mine, minerals, land and buildings.

ii) **Nature of contract entered into by company**

The company entered into contract with RICHE, for financing of construction of a railway line in Belgium.

iii) **Court's decision**

The court held that the transaction to finance the construction of railway line does not fall in the term 'general contractors' and hence this is ultra-vies and void.

19.1. Effects of Doctrine of Ultra Vires

1) Void–ab-initio

Ultra vires acts are null and void. The company is not bound by these acts. The company cannot sue or be sued upon ultra vires acts.

Even whole body of shareholders cannot ratify an ultra vires act even by a unanimous vote.

2) Injunction against the company

Where a company is about to undertake an ultra vires act, any member of the company can obtain an injunction order from the court and restrain the company from proceeding with it.

3) Personal liability of directors to the company

The directors of the company are personally liable to the Company for ultra vires acts. It is duty of the directors to ensure that the corporate capital is used only for the legitimate business of the Company.

4) Personal liability of directors to third company

The directors, being agents of the Company, cannot exceed the authority of the Company.

If they enter into ultra vires contract with any outsider, they will be personally liable for any loss suffered by the outsider.

5) Property acquired under ultra vires transaction

Where the company's money has been spent on ultra vires activity to acquire some property, the company has a right to protect such property against damage by third party.

The amount spent by Company on such property represents the company's capital.

Rights of third parties in case of ultra vires act

i) Suit against directors

The lenders may sue the directors for breach of warranty of authority and recover any loss sustained by him.

ii) Subrogation

If the company pays any debt using such money, the lender shall have a right to recover such money from the Company. However, he shall not have any right to any security which that creditor had.

iii) Charge on assets purchased out of money obtained by ultra vires act

If the company has purchased any asset out of such money, the lender shall have a first charge on that asset.

Effects of acts ultra vires the Directors or Articles

Acts ultra vires the directors or articles means those which are beyond the powers of the directors or powers given under the articles.

Such acts are not altogether void and inoperative. Such acts may be ratified by the members if it is intra vires the Company.

20. Doctrine of Constructive Notice

A. Applicability of Doctrine/ Presumption regarding provisions of MOA and AOA.

Once registered, the memorandum of association and articles of association of every Company are registered with ROC and are public documents. They can be inspected by any person by payment of a nominal fee at the ROC.

It is presumed that the person dealing with the Company has read the Memorandum and Articles irrespective of the fact whether he has actually read or not.

This is known as doctrine of constructive notice.

Thus, this doctrine, creates a presumption in the favour of the Company and against the person dealing with the company.

B. Effect

According to doctrine of constructive notice, every person dealing with the Company is presumed to have read and understood the contents of company's memorandum and articles.

Hence, it is duty of every person dealing with the Company to inspect these documents and make sure that his contract with the Company is in accordance with the provisions of these documents.

The doctrine prevents any person dealing with the Company from alleging that he did not know the provisions contained in MOA or AOA.

The legal effect of this doctrine is that if a person deals with the Company and the transaction is inconsistent with the provisions of memorandum and articles, he cannot enforce such a contract.

C. Decided case law

Kotta Venkataswamy vs. Chinta Ramamurthi

- The articles of the Company required that all the documents of the company should be signed by MD, the Secretary and a working director of the Company.
- A mortgage deed was signed only by the Secretary and a working director of the Company.
- It was held that the mortgage deed was invalid even though the plaintiff has acted in good faith and money was utilized for the benefit of the Company.

21. Doctrine of Indoor Management

A. Purpose of doctrine of indoor management

It operates in the favour of the person dealing with the Company and against the Company. The role of doctrine of indoor management is opposed to of the role of doctrine of constructive notice.

B. Presumption that internal proceedings are properly complied with

The person dealing with the Company can safely presume that the internal proceedings regarding an Act have been properly observed or complied with.

They need not enquire into the regularity of internal proceedings of the Company.

C. Effect of doctrine of indoor management

Where directors and other officers of the company are empowered under articles to exercise certain powers subject only to certain prior approvals or sanctions of the shareholders,

- the outsiders dealing with the company can assume that
- if directors or other officers are entering into these transactions
- they would have obtained the necessary sanctions.

A person dealing with Company can take benefit of doctrine of indoor management only if

i) he has knowledge of MOA and AOA; but
ii) has no knowledge of internal irregularity.

D. Decided case law

Royal British Bank vs. Turquand

- The articles of the Company stated that the directors of the company could borrow money on behalf of the Company if they are authorized by a resolution passed by shareholders in a general meeting.
- The directors borrowed money from Mr. Turquand without obtaining any authorization from the shareholders.
- Turquand had lent money to the Company assuming that the authorization from shareholders has been taken.
- It was held that money borrowed by the directors without the authorization from the shareholders amounted to internal irregularity.
- Thus, Mr. Turquand could recover the loan.

21.1. Exceptions of Doctrine of Indoor Management

1) Knowledge of irregularity

Where the person dealing with the company has actual or implied knowledge of irregularity regarding the internal management, the person cannot claim benefit under the doctrine of indoor management.

Decided case law

Howard vs. Patent Ivory Manufacturing Co.

- The directors of a company had an authority to borrow up to 1000 without sanction of shareholders in general meeting. For borrowing above 1000, consent of shareholders in general meeting was required.
- The directors themselves lent 3500 to the company.
- It was held that the directors had notice of internal irregularity and therefore the company was liable to them up to 1000 only.

2) Negligence

Where a person dealing with a Company could have discovered the irregularity if he had made proper enquires and exercised due care, then he cannot claim protection under the doctrine of indoor management.

Thus, where the transaction is unusual or not in ordinary course of business, the person dealing with the Company should make proper enquires and satisfy himself that the directors had authority to conduct such transactions.

Decided case law

Anand Bihari Lal vs. Dinshaw & Co. Ltd

- An accountant of the company entered into a contract with a third party to sell the property of the Company.

- It was held that the third party could not assume that an accountant can have the authority to sell the property of the Company.
- Thus, third party could not enforce such contract against the company even though third party acted in good faith.

3) Forgery

This rule does not apply to transactions involving forgery.

Where a document is forged by the officer of the Company, the person dealing with officer cannot claim the benefit of this doctrine. Thus, a Company cannot be held liable for forgery committed by its officers.

Decided case law

Ruben V Great Fingal Consolidation Company

- A person was issued a share certificate with common seal of the Company.
- Signature of 2 directors along with the secretary were required to issue such certificate.
- The secretary of the Company signed on the share certificate. The secretary also forged the signatures of 2 directors.
- The holder of such certificate contended that he was not aware of the forgery and it was not possible for him to check whether signatures were genuine or not, hence certificate issued to him should be valid.
- The court held that Company is not liable for the forgery by its officers and thus certificate was invalid.

4) No knowledge of the articles and MOA

A person who did not consult the articles and memorandum and is not aware of the contents of these documents at the time of making the contract cannot claim protection under this doctrine.

Decided case law

Rama Corporation vs. Proved Tin & General Investment Co.

- The articles of the investment company provided that the directors could delegate their powers to one of them.
- One of the directors of the Company entered into the contract with Rama corporation and received a Cheque from it.
- Rama Corporation had never read those articles. Later on, it was discovered that director was not delegated powers from BOD.
- It was held that Rama Corporation could not rely on the doctrine of indoor management as it did not know the powers could be delegated. Accordingly, the benefit of doctrine of indoor management was not available.

5) Ultra vires or illegal acts

Where the act done is ultra vires or illegal to the Company, the doctrine of indoor management does not apply.

6) Acts outside the scope of apparent

If an officer of a Company enters into a contract with a third party and if the act of the officer is beyond the scope of the authority, the company is not bound.

ARISE AWAKE AND STOP NOT TILL YOUR GOAL IS ACHIEVED

-Swami Vivekanand

About CA Kishan Kumar

- ★ Kishan Kumar is an **Associate member** of The Institute of Chartered Accountants of India.
- ★ He is a **throughout Rankholder** in CA examinations.
- ★ He himself scored **Exemption in EIS-SM** in his CA Inter Exam..
- ★ He has been **awarded by Nitish Kumar, Hon'ble Chief Minister** of Bihar for his excellence in the field of education.
- ★ Internationally renowned **University of South Wales** has also felicitated him for his aptitude and achievements during his academic life.
- ★ Kishan has worked with **Ernst & Young and PwC (Big 4 Firms)** and uses his practical corporate experience to make the subject more interesting and engaging.
- ★ His students have secured **marks as high as 85** and hundreds have scored exemptions.
- ★ He is committed to make meaningful contribution to the life of promising CA aspirants.

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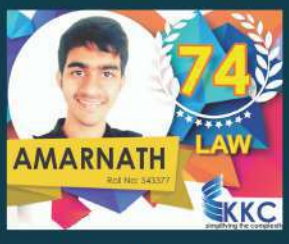

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CHAPTER 3
PROSPECTUS & ALLOTMENT OF SECURITIES
UNIT I - PROSPECTUS

Never let small minds convince you that your dreams are too big.

1. INTRODUCTION

One of the advantages of floating a company is raising of capital. Capital could be raised from public at large or from a defined group or inner circle (pre-known select group of persons). The former is called the 'Public offer' and the latter is called 'Private Placement'.

Capital acquisition is inflow of funds for the issuer and needs advertisement which should be in accordance with the relevant legal provisions so that any investor is not defrauded or be-fooled.

On successful closure of the application process, securities are allotted to investors which could be then listed on an appropriate segment of a recognised stock exchange.

2. PUBLIC OFFER AND MODES OF ISSUE OF SECURITIES [SEC 23]

Public offer [Explanation to Sec 23(2)]

The term 'public offer' includes

- initial public offer (IPO) or further public offer (FPO) of securities to the public by a company, or
- an offer for sale (OFS) of securities to the public by an existing shareholder,
- through issue of a prospectus.

Modes of issue of securities by a public company [Sec 23(1)]

A pubic company may issue securities to public

i) **through prospectus** - by complying with the provisions of the Companies Act, 2013;

ii) **through private placement** - by complying with the provisions of the Companies Act, 2013;

iii) **through a right issue or a bonus issue** - by complying with the provisions of this Act (section 62). Further, in case of a listed company or a company which intends to get its securities listed, it also needs to comply with the provisions of the SEBI Act, 1992 and the rules and regulations made there under.

Modes of issue of securities by a private company [Sec 23(2)]

A private company may issue securities

i) by way of rights issue or bonus issue in accordance with provisions of this Act; or

ii) through private placement in accordance with provisions of this Act.

The provisions of Section 23 are tabulated below:

	Public Company	Private Company
Public Offer (including IPO, FPO or OFS)	Yes	No
Private Placement	Yes	Yes
Rights issue / Bonus Issue	Yes	Yes
Compliance with SEBI rules and regulations	Yes, for listed company or company proposed to be listed	No

"Securities" include

i) Shares, stocks, bonds, debentures, debenture stock or other marketable securities;

ii) derivative;

iii) units or any other such instrument issued to the investors under any mutual fund scheme.

iv) Government securities;

v) such other instruments as may be declared by the Central Government to be securities; and

vi) rights or interests in securities;

Example:

The Board of Directors of M/s R Investments Ltd. have allotted shares to the investors of the company without issuing a prospectus with the Registrar of Companies, Mumbai. Here in the given case according to Section 23 of the Companies Act, 2013, a public company can issue securities to the public only by issuing a prospectus.

Section 26 (1) lays down the matters required to be disclosed and included in a prospectus and requires the filing of the prospectus with the Registrar before its issue.

So, the company has violated with the above provisions of the Act and hence the allotment made is void. The company will have to refund the entire moneys received and will also be punishable under section 26 (9) of the Act.

3. Offer of Invitation to the Public

Meaning of offer or invitation to the public

Offer or invitation to the public includes invitation to any section of the public whether selected as

i) members or debenture holders of the Company; or

ii) clients of the person issuing the prospectus; or

iii) in any manner.

What does not amount to 'offer or invitation to the public'

Offer of invitation to public does not include any offer or invitation if it is issued to the friends and relatives of promoters.

However, if offer or invitation is made to 200 or more persons, it amounts to an offer or invitation to the public.

4. Prospectus - Definition [Section 2(70)]

Prospectus means any document described or issued as a prospectus and includes

- a shelf prospectus; or

- red herring prospectus; or
- any notice, circular, advertisement or other document among others

for the *subscription or purchase of any securities of* ***body corporate*** *by the public.*

5. Prospectus Not Required to be Issued

a) Where an offer or invitation is made to the existing members (whether or not the member has the right of renunciation) or debenture holders of the company.

b) Where an offer or invitation is made to subscribers for shares or debenture which are

- uniform in all respects with shares or debenture previously issued
- for the time being dealt in or quoted on a recognized stock exchange.

c) Where no offer or invitation is made for issue of shares or debentures.

d) Where shares or debenture are issued by a private company.

6. Legal Rules as to Prospectus [Sec 26]

Matters to be Stated in Prospectus	Every prospectus issued by or on behalf of a public company either with reference to its formation or subsequently, shall be ➢ Dated; and ➢ Signed; and ➢ shall state such information and set out such reports on financial information as may be specified by the SEBI in consultation with the Central Government.
Date of prospectus	The date indicated in the prospectus shall be deemed to be the date of its publication.
Delivery of copy of prospectus to the Registrar	a) Before issue of prospectus by or on behalf of a company or in relation to an intended company, a copy of the prospectus shall be delivered to the Registrar for filing on or before the date of its publication. b) Such copy of the prospectus must be signed by every person who is named therein as a director or proposed director of the company or by his duly authorised attorney. c) Every prospectus shall, on the face of it, state that a copy has been delivered to the registrar for filing.
Time limit for issue of prospectus	In order to be valid, every prospectus must be issued within 90 days after the date on which a copy thereof is delivered to the registrar.
Expert's statement in Prospectus	A prospectus shall not include a statement purporting to be made by an expert unless- a) The expert is a person who is not, and has not been, engaged or interested in the formation or promotion or management of the company. b) The expert has given his written consent to the issue of the prospectus; and c) The expert has not withdrawn his consent before the delivery of a copy of the prospectus to the registrar for filing; and d) A statement is included in the prospectus that the expert has given his written consent and has not withdrawn such consent.
Definition of expert (Sec. 2(38))	'Expert' includes an engineer, a valuer, a chartered accountant, a company secretary, a cost accountant and any other person who has the power or authority to issue a certificate in pursuance of any law for the time being in force.

Punishment if 'issued prospectus' contravenes applicable provisions	If a prospectus is issued in contravention of the provisions of section 26, the a) company shall be punishable with ➢ fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and b) every person who is knowingly a party to the issue of such prospectus shall be punishable with ➢ imprisonment for a term which may extend to three years or ➢ with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or ➢ with both. [Sub- section (9)]

Example:

The Board of Directors of Dr. Sunny Pharmaceutical Limited has allotted shares to the investors at large without issuing a prospectus with the Registrar of Companies, Mumbai. In this regard, it is to be noted that a public company can issue securities to the public only by issuing a prospectus (Section 23).

Section 26 (1) lays down the matters required to be disclosed and included in a prospectus and requires the filing of the prospectus with the Registrar before it is issued.

In the given case, the company has violated the above provisions of the Companies Act, 2013 and hence the allotment made by it is void. The company will have to refund the entire moneys received and will also be punishable under section 26 (9) of the Act.

Section 30 & Detailed Contents of Prospectus shall be dealt in CA Finals as per ICAI Syllabus.

7. ABRIDGED PROSPECTUS [SEC 2(1) AND SEC 33]

- **Meaning of abridged prospectus [Sec 2(1)]**

"Abridged prospectus" means a memorandum containing such salient features of a prospectus as may be specified by the SEBI by making regulations in this behalf.

- **Abridged prospectus must be attached to application forms**

No form of application for the purchase of any of the securities of a company shall be issued unless such form is accompanied by an abridged prospectus.

- **Furnishing of prospectus on demand**

A copy of the prospectus shall, on a request being made by any person before the closing of the subscription list and the offer, shall be furnished to him.

- **When is abridged prospectus not required**

Where an application form is issued in connection with

i) bonafide invitation to a person to enter into an underwriting agreement with respect to such securities or

ii) where an application form is issued in relation to securities which were not offered to the public.
   a) Private placement in accordance with provisions of section 42
   b) Right issue in accordance with provisions of section 62
   c) Bonus issue in accordance with provisions of section 63.

- **Penalty for default**

The Company shall be liable for a penalty of INR 50,000 for each default.

8. SHELF PROSPECTUS [SECTION 31]

A. Meaning of shelf prospectus

"Shelf Prospectus" means a prospectus in respect of which

- securities or class of securities included therein are issued for subscription
- in one or more issues over a certain period
- without issue of a further prospectus.

B. Applicability of this section

The provisions of sec. 31 shall apply to any class or classes of Companies as the SEBI may provide by regulations.

C. Procedure of issue of securities under shelf prospectus:

i) Filing of shelf prospectus

Any class or classes of Companies as the SEBI may provide by regulations in this behalf, may file a shelf prospectus with the registrar at the stage of the first offer of securities in shelf prospectus.

ii) Validity of shelf prospectus

Shelf prospectus shall indicate a period not exceeding one year from the date of opening of the first offer of securities under shelf prospectus.

For second or subsequent offer of such securities issued during the period of validity of that prospectus, no further prospectus is required.

iii) Information memorandum

Prior to issue of second or subsequent offer of such securities under shelf prospectus, a company filing a shelf prospectus shall be required to file an information memorandum with Registrar containing all material facts relating to

i) New charges created;

ii) Changes in the financial position of the Company between the first offer of securities or the previous offer of securities and the succeeding offer of securities.

iii) Such other changes as may be prescribed.

Note: Information memorandum shall be filed with the registrar prior to the issue of a second or subsequent offer of securities under the shelf prospectus.

iv) Intimation of variations and opportunity to withdraw applications

Where a Company or any other person has received application for the allotment of securities along with advance payments of subscription, before such change,

i) It should intimate to the applicants about the change

ii) Opportunity must be given to the applicant to withdraw his application within 15 days of the receipt of intimation given by the company.

D. Constructing the term prospectus

An updated information memorandum, filed at the time of an offer of securities along with shelf prospectus for that issue, is known as the prospectus.

9. Red Herring Prospectus [Section 32]

Meaning

It means a prospectus which does not include complete particulars of the quantum or price of the securities included therein.

Procedure of issue of securities under Red Herring Prospectus

- A Company proposing to make an offer of securities may issue a red herring prospectus prior to issue of prospectus.
- A company proposing to issue a red herring prospectus shall file it with the registrar at least 3 days prior to the opening of the subscription list and the offer.
- A red herring prospectus shall carry the same obligations as are applicable to a prospectus and any variation between the red herring prospectus and a prospectus shall be highlighted as variations in the prospectus.
- Upon the closing of the offer of securities, final prospectus shall be filed with the registrar and the SEBI.
- The prospectus shall state:
  - i) The total capital raised, whether by way of debt or share capital;
  - ii) The closing price of the securities; and
  - iii) Any other details as are included in the red herring prospectus.

10. Deemed Prospectus (Offer for Sale) [Sec 25]

Section 25 of the Act states the law related to the document by which the offer for sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company.

- **Documents which deemed to be a prospectus**

Where a company allots or agrees to allot any security

- with a view to all or any of those securities being offered for sale to the public,
- any documents by which the offer for sale to the public is made

shall be deemed to be a prospectus issued by the Company.

Offer for Sale, as it commonly called, are commonly used by many companies to dilute promoters' holdings or to provide exit route to venture capitalist.

It is different from IPO or FPO in the sense that under OFS, securities are offered by earlier allotees through the issuer company instead of directly by the issuer company. In OFS there is no change in the Balance Sheet of the company as no new comes into picture.

- **Presumptions as to deemed prospectus**

Unless the contrary is proved, it shall be presumed that an allotment of securities or an agreement to allot securities was made with a view to the securities being offered for sale to the public if it is shown

i) that an offer of the securities for sale to the public was made within 6 months after the allotment or agreement to allot; or

ii) that the whole consideration had not been received by the Company in respect of the securities issued by it.

- **Signing of deemed prospectus**

Person making the offer is	Documents to be signed by

Company	by 2 directors of the company
Firm	by not less than one - half of the persons in the firm.

- **Effects**

i) All enactments and rules of law regarding the contents of prospectus shall apply to deemed prospectus.

ii) All enactments and rules of law regarding liability in respect of misstatement and omissions in prospectus shall also apply to deemed prospectus.

iii) There is no dilution of liability for the persons making the offer which is in addition to liability of the company whose securities are offered for sale.

iv) Additionally, below to be disclosed as well in the deemed prospectus:

a) the net amount of the consideration received or to be received by the company in respect of the securities to which the offer relates; and

b) the time and place at which the contract where under the said securities have been or are to be allotted may be inspected;

The purpose is to protect gullible investors in all possible manners.

11. Offer of Sale of Shares by Certain Members of Company [Sec. 28]

Offer of sale to be as per the procedure prescribed	Sec. 28 applies where, in accordance with the provisions of any law for the time being in force, certain members of a company propose to offer for sale to the public the shares held by them. Sec. 28 entitles such members to do so ➢ in consultation with the Board of Directors ➢ in accordance with such procedure as may be prescribed
Document for offer for sale deemed to be prospectus	▪ Any document by which the offer for sale to the public is made shall be deemed to be a prospectus issued by the company. ▪ All laws and rules with respect to ➢ the contents of the prospectus; and ➢ liability in case of mis-statement in prospectus shall apply as if such documents were a prospectus issued by the company.
Members to authorise the company to act on their behalf	The members, whose shares are proposed to be offered to the public shall- a) Collectively authorise the company to take all actions in respect of offer for sale on their behalf; and b) Reimburse the company all expenses incurred by the company.

12. Public Offer to be made in Dematerialized Form [Sec 29]

Securities could be held in physical or dematerialised form. However public offer of securities has to be mandatorily in demat form in accordance with the Depositories Act, 1996.

Demat ensures fool proof control over issue, sale, purchase, pledge, extinguishment of securities lending transparency and credibility to the entire process and securities markets.

Mandatory Dematerialization

a) Every company making public offer and

b) Such other class or classes of ~~*public*~~ companies as may be prescribed

shall issue the securities only in dematerialized form by complying with the provisions of the Depositories Act, 1996 and the regulations made thereunder.

In case of such class or classes of unlisted companies as may be prescribed, the securities shall be held or transferred only in dematerialised form in the manner laid down in the Depositories Act, 1996 and the regulations made thereunder.".

Optional dematerialization

Any other company may

i) convert its securities into dematerialization form; or

ii) issue its securities in physical form in accordance with the provisions of this Act; or

iii) issue its securities in dematerialized form

iv) in accordance with the provisions of the Depositories Act, 1996 and the regulations made there under.

According to Rule 9 of Companies (Prospectus and Allotment of Securities) Rules, 2014 (Dematerialization of securities)

The **promoters** of every public company making a **public offer of any convertible securities** may hold such securities **only** in dematerialised form:

Provided that the **entire holding of convertible securities** of the company by the promoters held in physical form up to the date of the initial public offer shall be **converted into dematerialised form before such offer is made** and thereafter such promoter shareholding shall be held in dematerialized form only.

According to Rule 9A (3), every holder of securities of an unlisted public company,-

a) who intends to transfer such securities on or after 2nd October, 2018, shall get such securities dematerialised before the transfer; or

b) who subscribes to any securities of an unlisted public company (whether by way of private placement or bonus shares or rights offer) on or after 2nd October, 2018 shall ensure that all his existing securities are held in dematerialized form before such subscription.

Rule 9A shall not apply to an unlisted public company which is:

i) a Nidhi;

ii) a Government company; or

iii) a wholly owned subsidiary.

It is to be noted that only unlisted public companies (subject to exceptions) are covered by Rule 9A and therefore, it is not necessary for a private limited company to get its securities dematerialised.

At present, there are two depositories available in India i.e. NSDL and CDSL. Various depository participants (DPs) are linked to them. Dematerialised securities are held by the investors in their respective accounts with the DP which keeps a track of transfer, transmission, charge creation etc. There are necessary enabling legal enactments to facilitate all such procedures.

13. Golden Rules of Framing a Prospectus

Prospectus must present whole picture	As the public invest their money in the company on the basis of the information disclosed in the prospectus, the prospectus must present before the public the whole picture of the Company.
Material facts should	All material facts relating to the nature of the company must be truly and accurately

be disclosed	disclosed in the prospectus.
Should not contain any misstatement	If the statement is misleading in the form and context in which it is included, it should not be included in prospectus.
Should not omit to disclose any material fact	It should not omit any matter which may mislead the investors and influence its decision to subscribe the shares.
Suppression of a fact	Suppression of a fact will make a prospectus misleading prospectus if inclusion of such fact might affect investor's decision to subscribe for the shares. **Example -** A prospectus stating that the Company is paying dividend regularly but it was not mentioned that the dividend was paid out of past reserves and actually the company was incurring losses. Therefore, the statement was held as misleading statement.

14. Misstatement in the Prospectus

Meaning of 'untrue statement' and 'prospectus containing untrue statement'

A prospectus shall be deemed to be 'prospectus including an untrue statement' if

i) it contains a statement which is misleading in the form and context; or
ii) any matter is omitted from the prospectus intentionally to mislead the investors.

Remedies against the company

Where an investor has been induced by the misleading prospectus to acquire the shares, he shall have the following remedies against the company:

i) Rights of rescission

Where a contract is entered into by fraud, the contract becomes voidable at the option of the aggrieved party.

Following conditions should be fulfilled by the investor to rescind the contract:

a) The prospectus was issued by or on behalf of the Company.
b) The prospectus contained misrepresentation of facts.
c) The misrepresentation was material.
d) The investor must have relied on the prospectus i.e. he must have subscribed the shares on the faith of the prospectus.
e) The misrepresentation must have induced the investor to purchase the shares.
f) The investor must rescind the contract within the reasonable time period.

Loss of right of rescission

a) The investor has not rescinded the contract within the reasonable time period.
b) The company goes into liquidation before the investor has started the proceedings to rescind the contract.
c) The investors expressly or impliedly affirm the contract after becoming aware of the misrepresentation by performing nay of the following actions:

- Attempts to sell shares.
- Executes transfer of shares.
- Pays call money.
- Receives dividend.
- Attends and votes at general meeting.

ii) Right to claim damages

Where the investor rescinds the contract to take shares, he may, in addition sue the Company for damages by way of interest and loss incurred.

14.1. Civil Liability [Section 35]

Where a person has subscribed for securities of a Company acting on any statement included or the inclusion or omission of any matter in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, following person shall be liable to pay compensation to everyone who has sustained such loss or damage:

a) The Company.

b) Every person who is a director of the Company at the time of the issue of the prospectus or every person who has authorized himself to be named and is named in the prospectus as a director of the Company.

c) Every person who is a director of the Company or has agreed to become such director either immediately or after an interval of time.

d) Every person who is a promoter of the Company.

e) Every person who has authorized the issue of the prospectus.

f) Every person who is an expert.

Key Points

- Loss or damage is an essential condition.
- Civil Procedure Code, 1908 is applicable
- Offence against the counter party.

Defenses available to these persons [Promoters, Directors and Experts etc]

No person shall be liable if they prove the following:

a) Withdrawal of consent - Having consented to become a director of the company, he withdrew his consent before the issue of the prospectus and that it was issued without his authority or consent; or

b) Prospectus issued without consent - That the prospectus was issued without his knowledge or consent and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.

c) Belief in truth of the misleading statement purported to be made by an expert - If a person proves that he had

- *reasonable ground to believe and did up to the time of the issue of the prospectus believe,*
- that the person making the statement was competent to make it and
- that the said person had given the consent to the issue of the prospectus and
- had not withdrawn that consent before delivery of a copy of the prospectus for filing or,
- to the defendant's knowledge, before allotment thereunder.

Unlimited Liability when prospectus issued with intent to defraud:

Where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose,

- every person referred to in subsection (1) shall be personally responsible, without any limitation of liability,

- for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.

14.2 Criminal Liability for Misstatements in Prospectus [Section 34]

Nature of criminal liability

Where a prospectus issued, circulated or distributed which includes any statement which is untrue or misleading in form on context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorizes the issue of such prospectus shall be liable under section 447.

Key Points

- Mens Rea (guilty mind) is an essential condition.
- Criminal Procedure Code, 1973 is applicable
- Offence is regarded committed against the state.

Defenses

i) **Immaterial statement -** If a person proves that such statement or omission was immaterial.

ii) **Belief in truth of the statement -** If a person proves that he had reasonable grounds to believe and did believe up to the time of issue of the prospectus, that the statement was true or the inclusion or omission was necessary.

Example

An allottee of shares in a Company brought action against a Director in respect of false statements in prospectus. The director contended that the statements were prepared by the promoters and he has relied on them and so director is not liable.

Answer

Yes, the Director shall be held liable for the false statements in the prospectus under sections 34 and 35 of the Companies Act, 2013. Section 34 imposes a criminal punishment on every person who authorises the issue of such prospectus, and section 35 more particularly includes a director of the company in the imposition of liability for such mis-statements. Therefore, in the present case the director cannot hide behind the excuse that he had relied on the promoters for making correct statements in the prospectus.

Example:

A company issued a prospectus. All the statements contained therein were literally true. It also stated that the company had paid dividends for a number of years, but did not disclose the fact that the dividends were not paid out of trading profits, but out of capital profits. An allottee of shares wants to avoid the contract on the ground that the prospectus was false in material particulars.

Answer: The non-disclosure of the fact that dividends were paid out of capital profits is a concealment of material fact as a company is normally required to distribute dividend only from trading or revenue profits and under exceptional circumstances can do so out of capital profits. Hence, a material misrepresentation has been made. Hence, in the given case the allottee can avoid the contract of allotment of shares.

14.3 Punishment for Fraudulently inducing Persons to invest Money [Sec 36]

Any person who either knowingly or recklessly makes any statement, promises or forecasts which is false, deceptive or misleading or deliberately conceals any material facts to induce another person to enter into

a) any agreement with a view to acquiring, disposing or subscribing for or under writing securities or

b) any agreement the purpose or the pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuation 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.

15. Action by Affected Persons [Section 37]

A suit may be filed or any other action may be taken under section 34 or section 35 or section 36 by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus.

Class Actions – Gift of Companies Act, 2013

Class action suit is for a group of people filing a suit against a defendant who has caused common harm to the entire group or class.

This is not like a common litigation method where one defendant files a case against another defendant while both the parties are available in court. In the case of class action suit, the class or the group of people filing the case need not be present in the court and can be represented by one petitioner. The benefit of these type of suits is that if several people have been injured by one defendant, each one of the injured people need not file a case separately but all of the people can file one single case together against the defendant.

It is cost effective way of legal recourse in case large number of small shareholders who are unable to file independent cases due to cost and time involved.

Before Companies Act, 2013; Class action suits in India were so far filed in the form of public interest litigations. Courts were free to dismiss these. These shareholders ran pillar to post right from the National Consumer Disputes Redressal Commission up to the extent of Supreme Court and had their claims rejected.

Example

M applies for share on the basis of a prospectus which contains mis– statement. The shares are allotted to him, who afterwards transfers them to N. Can N bring an action for a rescission on the ground of mis-statement under section 37 of the Companies Act, 2013?

Answer

No, N cannot bring an action for rescission of the contract to buy shares from M on the ground of mis-statement as under section 37 of the Companies Act, 2013. A suit may be filed or any other action may be taken under section 34 or section 35 or section 36 only by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus.

16. Private Placement [Sec 42]

- A company may make an offer or invitation of securities by way of private placement subject to the provisions of section 42.
- The term “private placement” means
  - any offer of securities or
  - invitation to subscribe securities
  - to a select group of persons (identified by Board)
  - by a company (other than by way of public offer)
  - through issue of a private placement offer letter and
  - by fulfillment of the condition specified in this section.
- This section lays the condition through which invitation can be made for private placement. These provisions shall not apply to

a) non-banking financial companies which are registered with the Reserve Bank of India under the Reserve Bank of India Act,1934 and

b) housing finance companies which are registered with the National Housing Bank under the National Housing Bank Act, 1987,

- The law contained in the provision is as follows:

i) Issue of private placement offer letter:

Without effecting to the provision of section 26, a company may make private placement through issue of a private placement offer letter.

A company shall issue private placement offer cum application letter only after the relevant special resolution or Board resolution has been filed in the Registry:

ii) Previous approval of shareholder:

The proposed offer of securities or invitation to subscribe securities should have been previously approved by the shareholder of the company, by a Special Resolution, for each of the offers or invitations.

Provided that in the explanatory statement annexed to the notice for shareholders' approval, the following disclosure shall be made:

a) particulars of the offer including date of passing of Board resolution;
b) kinds of securities offered and the price at which security is being offered:
c) basis or justification for the price (including premium, if any) at which the offer or invitation is being made;
d) name and address of valuer who performed valuation;
e) amount which the company intends to raise by way of such securities;
f) material terms of raising such securities, proposed time schedule, purposes or objects of offer, contribution being made by the promoters or directors either as part of the offer or separately in furtherance of objects; principle terms of assets charged as securities:

However, in case of offer or invitation for non-convertible debentures,

a) where the proposed amount to be raised through such offer does not exceed the limit as specified in 180 (1)(c) – SR is not required and relevant Board resolution would be adequate:

b) where the proposed amount to be raised through such offer exceeds the limit as specified in 180 (1)(c) - it shall be sufficient if the company passes **a previous special resolution only once in a year** for all the offers or invitations for such debentures during the year.

iii) Offer/ invitation to number of persons:

The offer of securities or invitation to subscribe securities, shall be made maximum to fifty or such higher number as may be prescribed [**200 persons** as specified in Rules] in a financial year and on such conditions (including the form and manner of private placement) as may be prescribed.

However, this does not include

a) qualified institution buyers and
b) employees of the company being offered securities under a scheme of employee's stock option as per provision of section 62 (1) (b).

Limit of 200 persons is **reckoned individually for each kind of security** that is equity share, preference share or debenture.

iv) Offer/ invitation made to more than the prescribed number of persons:

A company, listed/unlisted, makes an offer to allot or invites subscription, or allots, or enters into an agreement to allot, securities to more than the prescribed number of persons, the same shall be deemed to be an offer to the public and shall accordingly be governed by the provisions related to public issue.

v) No issue of fresh offer/invitation:

No fresh offer or invitation shall be made, unless

a) the allotments with respect to any offer or invitation made earlier have been completed; or
b) that offer or invitation has been withdrawn; or
c) abandoned by the company.

Provided that, subject to the maximum number of identified persons under sub- section (2), a company may, at any time, make more than one issue of securities to such class of identified persons as may be prescribed.

vi) Payment of amount:

All monies payable towards subscription of securities under this section shall be paid through cheque or demand draft or other banking channels but not by cash.

Provided that a company shall not utilize monies raised through private placement unless allotment is made **and the return of allotment is filed with the Registrar.**

vii) Time for allotment of securities:

The company shall allot its securities within 60 days from the date of receipt of the application money for such securities.

viii) Default in allotment of securities:

Where the company is not able to allot the securities within stated period, it shall repay the application money to the subscriber within 15 days from the date of completion of sixty days.

If the company fails to repay the application money within the aforesaid period, it shall be liable to repay that money with interest @ of 12 % per annum from the expiry of the sixtieth day.

ix) Separate Bank Account:

Monies received on application shall be kept in a separate bank account in a scheduled bank and shall be utilized only for the following purpose:

a) For adjustment against allotment of securities; or
b) For the repayment of monies where the company is unable to allot securities.

x) Offer made to the persons whose name is recorded:

Offers shall be made only to such persons whose names are recorded by the Company prior to the invitation to subscribe. Such person shall receive the offer by name, and a complete record of such offers shall be kept by the company.

Complete information about such offer shall be filed with the Registrar within a period of thirty days of circulation of relevant private placement offer letter.

xi) No publicity permitted:

Company shall not publish any public advertisement or utilize any media, marketing or distribution channels or agents to inform the public at large about such an offer.

xii) Filing with the registrar:

Whenever a company makes any allotment of securities, it shall file with the Registrar *within fifteen days from the date of the allotment*, a return of allotment, including the complete list of all security holders, with their full names, addresses, number of securities allotted and such other relevant information.

If a company defaults in filing the return of allotment within the prescribed period of 15 days, the company, its promoters and directors shall be liable to a penalty for each default of one thousand rupees for each day during which such default continues but not exceeding twenty-five lakh rupees.

xiii) Company to maintain record of bank account:

The payment to be made for subscription of securities shall be made from the bank account of the person subscribing such securities.

The company shall keep the record of the bank account from where such payment for subscription have been received.

xiv) Consequences of contravention:

a) If a company defaults in filing the return of allotment within the period prescribed under sub-section (8), the company, its promoters and directors shall be liable to

Penalty for each default	INR 1,000 for each day during which such default continues but ≤ INR 25 lakhs

b) If a company makes an offer or accepts monies in contravention of any provision of this section,

Persons liable	Penalty
Company, Promoters, Directors	i. May extend to – Amount involved in offer or invitation, or Two crore rupees, whichever is **lower**.
	ii. Company shall also refund all monies to subscribers within a period of thirty days of the order imposing the penalty.

c) If a company accepts issues private placement issue to persons exceeding 200, such offer shall be deemed to be a public offer and all the provisions of this Act and the Securities Contracts (Regulation) Act, 1956 and the SEBI Act, 1992 shall be applicable.

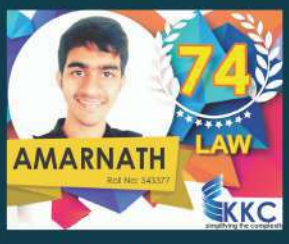
ARISE AWAKE AND STOP NOT TILL YOUR GOAL IS ACHIEVED

-Swami Vivekanand

About CA Kishan Kumar

- ★ Kishan Kumar is an **Associate member** of The Institute of Chartered Accountants of India.
- ★ He is a **throughout Rankholder** in CA examinations.
- ★ He himself scored **Exemption in EIS-SM** in his CA Inter Exam..
- ★ He has been **awarded by Nitish Kumar, Hon'ble Chief Minister** of Bihar for his excellence in the field of education.
- ★ Internationally renowned **University of South Wales** has also felicitated him for his aptitude and achievements during his academic life.
- ★ Kishan has worked with **Ernst & Young and PwC (Big 4 Firms)** and uses his practical corporate experience to make the subject more interesting and engaging.
- ★ His students have secured **marks as high as 85** and hundreds have scored exemptions.
- ★ He is committed to make meaningful contribution to the life of promising CA aspirants.

★ OUR STARS ★



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CHAPTER 3
PROSPECTUS & ALLOTMENT OF SECURITIES
UNIT II - ALLOTMENT

1. ALLOTMENT OF SHARES - MEANING

The prospectus issued by a company is the invitation to the public to apply for the fresh issue of the shares of the company. When an application is accepted by the company and share is allotted, it is called an allotment.

Allotment is the appropriation, out of previously non-appropriated capital of the company, of a certain number of shares to a person. Till such allotment, the shares do not exist as such. It is on allotment that the shares come into existence.

A valid allotment creates a binding contract between the company and the allottee.

The allotment is a fresh issue of shares. Reissue of forfeited shares is not allotment.

2. LEGAL RULES AS TO ALLOTMENT OF SHARES [SEC 39]

i) Minimum Subscription

Where a company offers its securities for subscription to public, no allotment of any securities of a company offered to the public for subscription shall be made unless the following two conditions are satisfied-

i) The amount stated in the prospectus as the minimum amount has been subscribed; and

ii) The sums payable on application for the amount so stated have been paid to and received by the company by cheque or another instrument.

ii) Amount of application

The amount payable on the application on every security shall not be less than

- 5% of the nominal amount of the security; or
- Such other percentage or amount, as may be specified by the **SEBI by making regulations** in this behalf.

iii) Time limit for receiving subscription and application money

Minimum amount stated in the prospectus must be prescribed and the sum payable on the application must be received within

- 30 days from the date of issue of the prospectus; or such other period as may be specified by the SEBI,

- otherwise the amount received by the company shall be returned within such time and manner as may be prescribed.

iv) Communication of allotment

No binding contract is created until the allotment is properly communicated to the applicant. Generally, the allotment is communicated through post. **Posting of properly addressed and stamped letter of allotment is a sufficient communication** even if the letter is delayed or lost in the course of postal transit.

v) Allotment against application only

An allotment can be made only on a written application form supplied by the company in this regard. Thus, valid allotment cannot be made on an oral request.

vi) Filing of prospectus or statement in lieu of prospectus

Before making an allotment, the company shall file with the registrar, a prospectus or a statement in lieu of prospectus. However, this requirement shall not apply to a private company in case of subsequent allotment of shares.

Consequences of default

A company and every officer who is in default shall be liable to a penalty of INR 1000 for each default for each day during which such default continues or INR 1,00,000 whichever is less.

Time period for repayment and consequences of non-payment

a) If the amount stated in the prospectus as the minimum subscription is not subscribed or the sum payable on application is not received within 30 days of issue of prospectus, then the application money shall be repaid

   - within a period of 15 days from the closure of the issue.

b) If any such money is not so repaid within such period, the directors of the company who are officers in default shall jointly and severally be liable to repay that money along with interest at the rate of 15% per annum

Manner of repayment: The application money to be refunded shall be credited only to the bank account from which the subscription was remitted.

3. Procedure of Allotment of Shares [Sec 39]

1) Resolution

Board of directors or the committee, as the case may be, should pass a resolution for allotment of shares. Thus, the allotment should be made by proper authority i.e. **BOD** or committee properly authorized to allot shares on behalf the BOD otherwise the allotment will be invalid.

2) Allotment letter

On allotment, the company should post an allotment letter to each allottee mentioning therein the details of shares allotted to them.

3) Return of allotment

Whenever a company having share capital makes an allotment of its shares, the company shall, within 30 days of allotment, file with the ROC a return of allotment in the Form PAS 3 along with the prescribed fee stating

- The number and nominal amount of the share allotted.
- Names, addresses and occupations of the allottees.
- The amount, if any, paid or due and payable on each share.

- Where shares are allotted as fully or partly paid up for consideration other than cash, there shall be attached to the Form PAS-3 a copy of the contract, duly stamped, pursuant to which the securities have been allotted together with any contract of sale if relating to a property or an asset, or a contract for services or other consideration.

  Further, a report of a registered valuer in respect of valuation of the consideration shall also be attached along with the contract.

- In the case of issue of bonus shares, a copy of the resolution passed in the general meeting authorizing the issue of such shares shall be attached to the Form PAS-3.

- In case the shares have been issued in pursuance of clause (c) of sub-section (1) of section 62 by a company other than a listed company whose equity shares or convertible preference shares are listed on any recognised stock exchange, there shall be attached to Form PAS-3, the valuation report of the registered valuer.

4) Register of members

Company shall enter the name of the allottee in the register of members along with the names and address and the occupation of each member.

5) Share certificate

The share certificates should be dispatched to the allottees within 2 months from the date of allotment.

Example

After receiving 80% of the minimum subscription as stated in the prospectus, a company allotted 100 equity shares in favour of 'X'. The company deposited the said amount in the bank but withdrew 50% of the amount, before finalisation of the allotment, for the purchase of certain assets. X refuses to accept the allotment of shares on the ground that the allotment is violative of the provisions of the Companies Act, 2013.

Answer

The company has received 80% of the minimum subscription as stated in the prospectus. Hence, the allotment is in contravention of section 39(1) of the Companies Act, 2013 which prohibits a company from making any allotment of securities until it has received the amount of minimum subscription stated in the prospectus. Under section 39 (3), it is required to refund the money received (i.e. 80% of the minimum subscription) to the applicants. It has no other option available.

Therefore, in the present case, X is within his rights refuses to accept the allotment of shares which has been illegally made by the company

4. IRREGULAR ALLOTMENT

Reason for Irregular Allotment	Consequences
1. Public offer of securities by a company without issuing a prospectus.	Company and every officer of the company who is in default shall be punishable with fine up to INR 10,000/- and where the contravention is continuing one, with a further fine up to INR 1,000/- for every day during which the contravention continues.
2. The prospectus issued by the company is misleading or does not contain the maters required to be included therein. **3.** The prospectus is issued to the public without first delivering to the registrar, a copy of the prospectus.	**a) Company:** Minimum fine: INR 50,000 Maximum fine: INR 3,00,000 **b) Every person who is knowingly a party to the issue of such prospectus:** ▪ Maximum imprisonment: 3 years; or ▪ Minimum fine: INR 50,000 Maximum fine: INR 3,00,000 or ▪ Both

Reason for Irregular Allotment	Consequences
4. In case of a public offer of securities, minimum subscription is not received but allotment of securities is made by the company. **5.** Application money payable on securities is less than 5% of the nominal value of the security or such other percentage or amount as may be specified by SEBI. **6.** Return of allotment is not filed with the registrar after making allotment of securities.	Company and every officer who is in default shall be liable to a penalty for each default of INR 1,000 per day during which such default continues or INR 1,00,000 whichever is less.
7. Public offer of securities is made by the company without first obtaining the permission for listing of securities from any stock exchange. **8.** Moneys received on application are not kept in a separate bank account in a scheduled bank.	**a) Company** Minimum fine: INR 5,00,000 Maximum fine: INR 50,00,000 **b) Every officer of the company who is in default** ▪ Maximum imprisonment: 1 year or ▪ Minimum fine: INR 50,000; Maximum fine: INR 3,00,000 or ▪ Both

5. Securities Dealt in Stock Exchange [Sec 40]

A. Application to one or more stock exchanges

Every company making public offer shall

- before making such offer
- make an application to one or more recognized stock exchange or exchanges and
- obtain permission for the security to be dealt with in such stock exchange or exchanges.

B. Prospectus to state the name or names of the stock exchange

Prospectus shall also state the name or names of the stock exchange in which the securities shall be dealt with.

C. Application money to be kept in separate bank account

All monies received on application from the public for subscription to the securities shall be kept in a separate bank account in a scheduled bank and shall not be utilized for any purpose other than:

i) For adjustment against allotment of securities where the securities have been permitted to be dealt with in the stock exchange or stock exchanges specified in the prospectus.

ii) For the repayment of monies, within the time specified by the SEBI, received from applicants in pursuance of the prospectus where the company is, for any other reason, unable to allot securities.

D. No waiver

Any conditions purporting to require or bind any applicant for securities to waive compliance with any of the requirement of this section shall be void.

Example

A public limited company which went in for Public issue of shares had applied for listing of shares in three recognised Stock Exchanges and out of it only two had given permission for listing. Can the company proceed for allotment of shares?

Answer

Every company making a public offer shall, before making such offer, make an application to one or more recognised stock exchange or exchanges and obtain permission for the securities to be dealt with in such stock exchange or exchanges. [Section 40 (1)]

Where a prospectus states that an application has been made, such prospectus shall also state the name or names of the stock exchange in which the securities shall be dealt with. [Section 40 (2)]

From the above it is clear that not only the company has to apply for listing of the securities at a recognized stock exchange but also obtain permission thereof before making the public offer.

Hence, under the Companies Act, 2013 by making the offer of shares before getting the approval from the stock exchanges, it has violated the provisions of section 40.

6. UNDERWRITING COMMISSION [SECTION 40(6)]

A. Meaning of Underwriter

Underwriter means an intermediary who undertakes to subscribe to the securities offered by the company in case these are not subscribed by the public.

B. Conditions for payment:

A company may pay commission to any person in connection with the subscription to its securities subject to such conditions as may be prescribed.

C. Conditions prescribed under the Rule 13 of Companies (Prospectus and Allotment of Securities) Rules, 2014 for payment of underwriting commission.

i) **Authorized by the Articles:** The payment of underwriting commission shall be authorized by the articles of the company.

ii) **Source of Payment:** The underwriting commission may be paid out of proceeds of the issue or out of the profits of the company or both.

iii) **Maximum Rate:** The rate of commission paid or agreed to be paid shall not exceed.

- **In the case of shares** - **5%** of the price at which the shares are issued or the rate authorized by the articles; whichever is **less**.
- **In the case of debenture** - **2.5%** of the price at which the debentures are issued or the rate authorized by the articles; whichever is **less.**

iv) **Disclosure of the particulars:** The prospectus of the company shall disclose the following particulars -

a) the name of the underwriters;

b) the rate and amount of the commission payable to the underwriter; and

c) the number of securities which is to be underwritten or subscribed by the underwriter absolutely or conditionally.

v) No under writing commission shall be paid on securities which are not offered to the public for subscription.

vi) A copy of underwriting agreement shall be delivered to the registrar at the time of delivery of prospectus.

Example:

The Board of Directors of a company decide to pay 5% of issue price of shares as underwriting commission to the underwriters. On the other hand, the Articles of Association of the company permit only 3% commission. The Board of Directors further decide to pay the commission out of the proceeds of the share capital. Are the decisions taken

by the Board of Directors valid under the Companies Act, 2013?

Answer:

Under the Companies (Prospectus and Allotment of Securities) Rules, 2014 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.

The same rules allow the commission to be paid out of proceeds of the issue or the profit of the company or both. Therefore, the decision of the Board of Directors to pay 5% commission to the underwriters is invalid while the decision to pay out of the proceeds of the share issue is valid.

ARISE AWAKE AND STOP NOT TILL YOUR GOAL IS ACHIEVED

-Swami Vivekanand

About CA Kishan Kumar

- ★ Kishan Kumar is an **Associate member** of The Institute of Chartered Accountants of India.
- ★ He is a **throughout Rankholder** in CA examinations.
- ★ He himself scored **Exemption in EIS-SM** in his CA Inter Exam..
- ★ He has been **awarded by Nitish Kumar, Hon'ble Chief Minister** of Bihar for his excellence in the field of education.
- ★ Internationally renowned **University of South Wales** has also felicitated him for his aptitude and achievements during his academic life.
- ★ Kishan has worked with **Ernst & Young and PwC (Big 4 Firms)** and uses his practical corporate experience to make the subject more interesting and engaging.
- ★ His students have secured **marks as high as 85** and hundreds have scored exemptions.
- ★ He is committed to make meaningful contribution to the life of promising CA aspirants.

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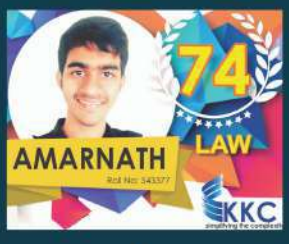

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CHAPTER 4A
SHARE CAPITAL & DEBENTURES

The will to succeed is important. But what is more important is the will to prepare.

1. INTRODUCTION

The share capital is the lifeblood for running the affairs of the company. Sometimes after the issue of capital a company may either alter or reduce the share capital depending upon the exigencies of the situation.

For desired share capital, a company may also raise a debenture which have to be registered as a charge.

Shares and debentures are financial instruments for raising funds for the company. Under the Companies Act, 2013, these are jointly referred to as "Securities".

Generally, shares depict ownership interest in a company with entrepreneurial risks and rewards whereas debentures depict lender's interest in the company with limited risks and returns.

Both these financial instruments are presented on the liabilities side of the issuer company and on the assets side of the investor or lender respectively.

Legal provisions related to these instruments are covered in Chapter IV of the Companies Act, 2013 (comprising sections 43 to 72) and the Companies (Share Capital & Debentures) Rules, 2014 as amended from time to time.

2. SHARE CAPITAL

Meaning

- As per section 2(84), "share" means a share in the share capital of a Company and includes stock.
- Share capital of the Company refers to the amount invested in the Company for it to carry out its operations.
- A share is the smallest unit into which the share capital of a company is divided.

Nature

a) Share, debenture or other interest of any member in a company shall be movable property.

b) It shall be transferable in any manner provided for in the Articles of Association of the Company.

3. CLASSIFICATION OF CAPITAL

Authorised capital

- Authorized capital or nominal capital or registered capital means such capital as is authorized by the memorandum of a company to be the maximum amount of share capital of the company. [Sec 2(8)]

- Simply speaking, authorized capital means the maximum capital that can be issued by a company during its lifetime. A company cannot issue capital exceeding the authorized capital. In case the company intends to issue capital exceeding the authorized capital, it has to first increase the authorized capital.
- The amount of authorized capital is stated in the capital clause of memorandum.
- At the time of registration of the company, the company has to pay fees to CG which is calculated with respect to authorized capital. Similarly, at the time of increasing the authorized capital, the company has to pay fees to CG which is calculated on the basis of difference between the increased authorized capital and existing authorized capital.

Issued capital

- Issued capital means such capital as the company issued from time to time for subscription [sec 2(50)].
- Simply speaking, issued capital is that part of authorized capital which has been, for the time being, issued by the company.
- It includes the share capital issued for cash as well as for consideration other than cash.

Subscribed capital

- Subscribed capital means such part of the capital which is, for the time being, subscribed by the members of a company [sec 2(86)].
- Simply speaking, subscribed capital is that part of issued capital which has been subscribed to by the members.

Called up capital

- Called up capital means such part of the capital which has been called for payment [sec 2(15)].
- Simply speaking, called up capital is that part of subscribed capital which has been, for the time being, called by the company.

Paid up capital

- Paid up share capital or share capital paid up means such aggregate amount of money received as paid up in respect of shares issued and also includes any amount credited as paid up in respect of shares of the company but does not include any other amount received in respect of such shares by whatever name called [sec 2(64)].
- Simply speaking, paid up capital means that portion of called up capital which has been, for the time being, paid by the members.
- It can be arrived at by deducting calls in arrears from the called-up capital.

Note: A company normally pays dividend on nominal value of shares. However, if authorized by its Articles, a Company may pay dividends in proportion to the amount paid up on each share.

Example 12: ABC Ltd. was registered with Registrar with an Authorised capital of INR 2,00,00,000 where each share is of INR 10. In response to the advertisements made by the company to buy shares in the company, applications have been received for 10,00,000 shares but company actually issued 700,000 shares where company has called for INR 8 per share. All the calls have been met in full except three shareholders who still owe for their 6000 shares in total.

Amount of various share capital

Authorized share capital = INR 2,00,00,000 (2 crores)

Subscribed capital = 10,00,000 x 10 = INR 1,00,00,000 (1 Crore)

Issued capital = 7,00,000 x 10 = INR 70,00,000

Called-up capital = 7,00,000 x 8 = INR 56,00,000

Paid-up capital = 56,00,000 – (6000 x INR 8) = INR 55,52,000

4. Publication of Authorized, Subscribed and Paid up Capital [Sec 60]

Disclosures required

Where any notice, advertisement or other official publication or

- any business letter, billhead or letter paper of a company
- contains a statement of the amount of the authorized capital of the company,
- such document shall also contain a statement
- in an equally prominent position and in equally conspicuous characters
- of the amount of subscribed capital and the amount of paid up capital.

Fine in case of default

Company – INR 10,000 for each default

Every officer who is in default - INR 5,000 for each default

5. Kinds of Share Capital [Sec 43]

A. Equity share capital

Equity share capital means all share capital which is not preference share capital.

Types of equity share capital

Equity share capital may be divided on the basis of

i) Voting rights; and

ii) Differential rights as to dividend, voting rights or otherwise, according to the rules.

B. Preference share capital

Preference share capital means that part of the issued share capital of the Company which carries a preferential right with respect to

i) Payment of dividend, either as a fixed amount or an amount calculated at a fixed rate; and

ii) Repayment, in the case of winding up or repayment of capital, of the amount of the share capital paid-up.

Kinds of preference shares

i) Irredeemable preference shares

According to sec. 55 of the Act, a Company limited by shares cannot issue any preference shares which are irredeemable.

ii) Redeemable preference shares

A company limited by shares may, if so authorized by its Articles, issue preference shares which are redeemable within a period not exceeding 20 years from the date of their issue.

Capital deemed to be preference capital

Capital is deemed to be preference capital irrespective of whether it is entitled to either or both of the following additional rights namely:

i) **In respect of dividends –** Participation with equity shares in profits of the Company (fully or to a limited extent) after payment of dividends to equity shareholders.

Example: After payment of dividend of 25% to equity shares, balance surplus will be shared by preference and equity shareholders.

ii) In respect of capital - Participation with equity shares in any surplus of the Company (fully or to a limited extent) remaining after repayment of entire capital.

Note: Section 43 shall not apply to Private companies where Memorandum or Articles so provides provided such Private Company has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar.

6. Issue of Shares with Differential Rights

- A DVR share is like an ordinary equity share but it provides no/fewer voting rights to the shareholder.
- The difference in voting rights can be achieved by reducing the degree of voting power in lieu of other benefits like increased dividend pay-out.
- Small investors are more interested in higher dividend. They are generally not interested in voting rights.

In Indian listed companies, there are two companies which have issued differential voting rights shares:

- Tata Motors
- Future Retail

Empirically, aforesaid DVRs (no voting rights) are traded at lower valuations vis-à-vis their counterparts with voting rights, other things being equal.

Conditions posed by Rule 4 of the Companies (Share Capital and Debentures) Rules, 2014

Any company, whether it is unlisted, listed or a public company limited by shares, shall issue equity shares with differential rights as to dividend, voting or otherwise only if following conditions are fulfilled:

i) Authorization by Articles: The Articles of Association of the company authorizes the issue of shares with differential rights.

ii) Ordinary Resolution: The issue of shares is authorized by an Ordinary Resolution passed at a General Meeting of the shareholders.

Provided that 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.**

iii) Limit: The shares with differential rights shall not exceed

- seventy-four percent of total voting power including voting power in respect of including equity shares with differential rights issued at any point of time.

iv) The company has NOT DEFAULTED in filing financial statement and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares.

v) 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.

vi) The company has NOT DEFAULTED in payment of

a) The dividend on preference shares; or

b) Repayment of any term loan from public financial institution or state level financial institution or scheduled bank that has become repayable or interest payable thereon; or

c) 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 of the Central Govt.

vii) The company has NOT BEEN PENALIZED by Court or Tribunal during last 3 years for any offence under the

a) Reserve Bank of India Act, 1934,
b) Securities and Exchange Board of India Act, 1992,
c) Foreign Exchange Management Act, 1999 or any other special Act.

The Rules further provide that the

- **Restriction on conversion of equity share capital with voting rights into equity share capital carrying differential voting rights:** Company shall not convert its exiting equity share capital into equity share capital carrying DVR and vice-versa.
- **Rights of the holders of the equity shares with differential rights:** The equity shares with differential rights shall enjoy all other rights such as bonus shares, right shares etc. which the holder of equity shares are entitled to, subject to the differential rights with which such shares have been issued.
- **Particulars of shares to be maintained in the register of members:** The company issuing equity shares with differential rights shall ensure that the register of members contains all the relevant particulars of the shares so issued along with details of the shareholders.
- **Disclosures in register of members**

  The register of members, maintained u/s 88, shall contain all the relevant particulars of the shares with differential rights issued along with details of the shareholders.
- **Disclosures in explanatory statement**

  The explanatory statement to be annexed to the notice of the general meeting in pursuance of section 102 or of a postal ballot in pursuance of section 110 shall contain the prescribed particulars.
- **Disclosures in Board's Report**

  The board of directors shall disclose the prescribed details in the Board's Report for the financial year in which the issue of equity shares with differential rights was completed.

7. Issue of Preference Shares [Section 55]

- **Company to issue redeemable preference shares:** Company limited by shares cannot issue preference shares which are irredeemable.
- **Period for redemption of preference shares:** The term of preference shares shall not exceed 20 years.

  The term of preference shares may exceed 20 years subject to following conditions:

  i) Such preference shares are issued for infrastructural project as specified under Schedule VI.

  ii) The period of redemption shall not exceed 30 years.

  iii) The company shall redeem a minimum 10% of such preference shares every year beginning from the 21st year or earlier on proportionate basis at the option of the preference shareholders.

A. Conditions for issue of preference shares

A company having a share capital may issue preference shares subject to the following conditions namely:

i) The issue of such shares has been authorized by Articles.

ii) The issue of such shares has been authorized by passing a Special Resolution in the GM of the Company.

iii) The company, at the time of such issue of preference shares, has no subsisting default in the redemption of preference shares issued or in payment of dividend due on any preference shares.

B. SEBI regulation

Further, a Company intending to list preference shares on a recognized stock exchange shall issue such shares in accordance with the regulations made by the SEBI in this behalf.

8. Redemption of Preference Shares [Section 55]

A. Redemption of preference shares

A Company may redeem its preference shares only on the terms on which they were issued or as varied after due approval of preference shareholders under sec. 48 of the Act.

B. Conditions for redemption

Preference shares can be redeemed under following conditions;

i) Fully Paid Shares: Preferences shares shall be redeemed only when they are fully paid up.

ii) Source of Redemption: Redemption can be made out of any of the two sources:

a) out of the profits of the company which would otherwise be available for dividends; or
b) out of the proceeds of a fresh issued of shares made for the purpose of such redemption.

iii) Creation of CRR

Creation of CRR is mandatory if preference shares are redeemed out of profits.

Amount to be transferred to CRR out of profits of the Company = Nominal Value of preference shares redeemed out of profits.

Example

During the current financial year, the Board of Directors of Vintee Lifestyles Garments Limited is to undertake redemption of 20,000 preference shares of INR 100 each at a premium of INR 20 per share. It is made out by the Accounts Department that the profits are sufficient to meet the ensuing liability arising out of redemption of preference shares at premium.

In this case, the amount that needs to be transferred to CRR account, if preference shares are redeemed at a premium out of profits which are otherwise available for dividend, is INR 20,00,000 being the sum equal to the nominal amount of the preference shares to be redeemed. There is no need to transfer to CRR account any amount paid towards premium.

iv) Premium payable on redemption

In case of prescribed class of Companies whose financial statement comply with AS prescribed u/s 133	In any other case
i) Premium payable on redemption shall be provided for out of the profits of the company. ii) In case of preference share capital issued before the commencement of this Act, premium payable on redemption may be provided for- a) Out of the profits of the company; or b) Out of securities premium account.	Premium payable on redemption may be provided for- a) Out of the profits of company; or b) Out of securities premium account.

v) Utilisation of CRR: The capital redemption reserve account may be applied by the Company in issue of fully paid bonus shares.

The provisions of this Act relating to reduction of share capital of a Company shall, except as provided in this section, apply as if the capital redemption reserve account were paid up share capital of the Company.

C. In case of unredeemed preference shares

Where a company is not in a position to redeem any preference shares or pay dividend on such shares in accordance with the terms of issue (such shares hereinafter referred to as unredeemed preference shares), it may—

a) with the consent of the holders of three-fourths in value of such preference shares, and

b) with the approval of the Tribunal on a petition made by it in this behalf,

issue further redeemable preference shares equal to the amount due, including the dividend thereon, in respect of the unredeemed preference shares.

On the issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed.

For the removal of doubts, it is hereby declared that the issue of further redeemable preference shares or the redemption of preference shares under this section shall not be deemed to be an increase or, as the case may be, a reduction, in the share capital of the company.

9. VOTING RIGHTS [SECTION 47]

A. Voting Rights of Equity Shareholders

- Every member of a Company limited by shares and holding equity shares shall have a right to vote on every resolution placed before the Company.
- The voting right of a shareholder on a poll shall be proportionate to his share in the paid-up equity share capital of the company.

B. Voting Rights of Preference Shareholders

- In case of member of a company limited by shares and holding preference shares, he shall have a right to vote only on resolution

  i) which directly affects rights attached to his preference shares; or
  ii) for the winding up of the company; or
  iii) for the repayment or reduction of equity share capital.

- Preference shareholders are entitled to vote on every resolution placed before the Company at any meeting if the dividends due on such class of preference shares are not paid for a period of two or more consecutive years.

C. Proportion of Voting Rights

In aforesaid cases, voting rights shall be computed on the basis of joint proportion of equity and preference share capital i.e. the

- proportion of voting rights of equity shareholders to the voting rights of preference shareholders shall be
- in same proportion as the
- paid-up capital in respect of the equity shares bears to the paid-up capital in respect of preference shares.

In a nutshell, voting rights for securities are not based on principles of adult/universal franchise i.e. one person one vote but these are based on the class of shares and on monetary value of investments at face value.

Note: Section will not apply to private company if articles so provide. Thus, Private company could be more innovative in terms of voting rights if permitted by their Memorandum or Article of Association.

For example, if AOA of a private company says that section 47 is not applicable to it then in this case AOA will become superior and section 47 of the Act will not be applicable.

10. VARIATION OF SHAREHOLDERS RIGHTS [SECTION 48]

A. Authorization to make variation

Where share capital of a Company is divided into different classes of shares, the rights attached to the shares of any class may be varied-

i) If provisions with respect to such variation is contained in the Memorandum or Article of the company; or

ii) In case of absence of any such provision in the Memorandum or Articles, if such variation is not prohibited by the terms of issue of the shares of that class.

B. Variation in rights of shareholders with consent

Such variation of rights of shares of particular class can be done in either of the following ways:

i) With the consent in writing of the holders of not less than 3/4th of the issued shares of that class; or

ii) By means of a Special Resolution passed at a separate meeting of the shareholders of that class.

C. Where variation by one class of shareholder affect the rights of any other class of shareholder

Along with all the requirements of 'B', the consent of 3/4th of such other class of shareholders shall also be obtained and the provisions of this section shall apply to such variation.

D. Rights of dissenting shareholders to make an application to the Tribunal

Where the holders of such class of shares who

- hold not less than 10% shares of such class; and
- has not consented to such variation or had not voted in favour of the special resolution for the variation,

they may apply to the Tribunal to have the variation cancelled.

- **Time to file an application for cancellation of variation**

  Such application shall be made within 21 days

  - after the date on which the consent was given; or the resolution was passed
  - and may be made on behalf of the shareholders entitled to make the application.

- **Confirmation of Tribunal is required which is binding on Shareholders**

  Under above circumstance, the variation shall not have effect unless and until it is confirmed by the Tribunal. The decision of the Tribunal on the application shall be binding on the shareholders.

- **Filing copy of order with the Registrar**

  The company shall file a copy thereof with the Registrar within thirty days of the date of the order of the Tribunal.

E. Default in complying with the provisions

Where any default is made in complying with the provisions of this section;

i) The company shall be punishable with fine which shall not be less than INR 25,000 but which may extend to INR 5,00,000; and

ii) Every officer of the Company who is in default shall be punishable with:

- Imprisonment for a term which may extend to 6 months; or
- Fine which shall not be less than INR 25,000 but which may extend to INR 5,00,000; or

- both.

11. Calls, Calls in Advance and Incidental Matters [Sec. 49 to 51]

Section 49

Calls are made by the company on security holders to pay the amount called up in respect of partly paid up securities.

Uniform Call: A call shall be made on a uniform basis on all shares falling under the same class.

There cannot be any discrimination between shareholders of the same class as regards amount and time of payment of call.

Meaning of 'same class'

The shares on which different amounts have been paid up shall not be deemed to be the shares falling under the same class.

Power of BOD to make calls

The Board may, from time to time, make calls upon the members in respect of any monies unpaid on their shares (whether on account of nominal value of shares or by way of premium). A Board Resolution must be passed to make valid call.

11.1. Company to accept Unpaid Share Capital, although not called up/Calls in Advance [Sec 50]

Meaning

- The Board may, if it thinks fit, receive from any member all or any part of the monies uncalled and unpaid upon any shares held by him, if he is willing to advance the same.
- Specific power is required in the Articles to accept the calls.
- Amount paid as calls in advance is non-refundable.

Interest on calls in advance

- The company is liable to pay interest on calls paid in advance.
- The interest shall be paid at such rate as may be specified in the Articles.
- The rate of interest on calls in advance shall be such as agreed between the Board and the member paying calls in advance, but not exceeding 12% per annum.
- The interest is payable whether or not the company has any profits i.e. the interest may be paid out of capital.

Rights in relation to Calls in Advance

Voting Rights – A member is not entitled to any voting rights in respect of 'calls in advance' until that amount has been called up.

In other words, advance payment will never lead to increased voting rights but delayed payment of call money could be the reason of decreased voting rights.

Other Rights

a) The liability of the member to pay the future calls is extinguished to the extent of calls paid in advance by him.

b) In the event of winding up of the Company, the amount paid as calls in advance along with interest shall be repaid before repayment of capital to the members, but after the creditors have been paid off.

Example

"Moonstar Ltd" is authorised by its Articles to accept the whole or any part of the amount of remaining unpaid calls from any member although no part of that amount has been called up. 'A', a shareholder of the Moonstar Ltd., deposits in advance the remaining amount due on his shares without any calls made by "Moonstar Ltd.".

In the given case Mr. A, has deposited in advance the remaining amount due on his shares without any calls made by 'Moonstar Ltd'. Since, 'Moonstar Ltd' was authorized to accept the unpaid calls by its articles, hence this is a valid transaction.

Example

Coriander Masale Limited has issued 10,00,000 equity shares of INR 10 each on which INR 6 per share has been called till allotment and the first and final call of INR 4 is yet to be made. Reena holds 10,000 shares on which she has paid whole of INR 10 per share. In the upcoming extra-ordinary general meeting of the company she wants to exercise her voting rights as the owner of fully paid-up shares.

However, the company cannot permit her as she does not have voting right in respect of the 'advance amount' paid by her in respect of first and final call. The restriction will continue till the amount is duly called up by the company.

11.2. Payment of Dividends in Proportion to Amount Paid-up [Sec 51]

Generally, dividend is paid as a proportion of nominal value of shares.

However, the Articles of a company may provide that dividend shall be paid in proportion to the amount paid-up on each share.

12. Issue of Shares at Premium [Sec 52]

A. Issue of shares at premium

Where a Company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a securities premium account.

B. Utilisation of securities premium

The securities premium account may be applied by the company for following purposes

i) Issuing of fully paid bonus shares to the members of the Company.

ii) Writing off preliminary expenses of the Company.

iii) Writing off the expense or commission paid or discount allowed on issue of shares or debenture of company.

iv) Providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company.

v) Buy back of fully paid shares under section 68.

C. Utilisation of securities premium in case of Certain class of companies

Certain class of companies whose financial statement comply with the accounting standards prescribed under sec. 133 can utilize security premium account only for the following purpose: -

i) Issue of fully paid bonus shares; or

ii) In writing off the expenses of or the commission paid or discount allowed on any issue of equity shares of the company; or

iii) For buy back of fully paid shares under section 68.

Note: The provisions of this Act relating to reduction of share capital of a company shall, except as provided in sec 52, apply as if the securities premium account were the paid-up share capital of the company.

Hence, utilization of securities premium for any other purpose shall be treated as reduction of share capital and all the provisions of reduction of share capital shall be applicable in such cases.

13. Issue of Shares at Discount [Section 53]

A. Issue of shares at discount Prohibited

A company is prohibited from issuing shares at discount except in case of

i) issue of sweet equity shares u/s 54.

ii) issue of shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

B. Share issue at a discounted price to be void

Any share issued by a Company at a discounted price shall be void.

C. Contravention of these provision

Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a

- **penalty** which may extend to an amount equal to the amount raised through the issue of shares at a discount or
- five lakh rupees,
- whichever is less.

The company shall also be liable to refund all monies received with interest at the rate of twelve per cent per annum from the date of issue of such shares to the persons to whom such shares have been issued.

Note:

It is clear for the reading of section 52 and 53 that these **restrictions are only on issue of shares,** it could be equity or preference but not on any debt related products like bonds or debentures.

14. Issue of Sweat Equity Shares [Section 54]

Definition of issue of sweat equity shares

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 them know how or making available rights in nature of intellectual property rights or valuable additions, by whatever name called.

It is issued to keep employees of a company motivated by making them partner in growth of the Company.

Meaning of Words

"Employee" means-

a) a permanent employee of the company who has been working in India or outside India; or

b) a director of the company, whether a whole-time director or not; or

c) an employee or a director as defined in sub-clauses (a) or (b) above of a subsidiary in India or outside India, or of a holding company of the company;

'Value additions' means actual or anticipated economic benefits derived or to be derived by the company from an expert or a professional for providing know-how or making available rights in the nature of intellectual property rights, by such person to whom sweat equity is being issued.

Conditions to be satisfied for issue of sweat equity shares

i) Shares of a class which has already been issued

Sweat equity shares must belong to a class of shares which has already been issued.

ii) Special Resolution

The issue is authorized by a Special Resolution passed by the Company.

The resolution specifies the

a) number of shares,

b) the current market price,

c) consideration, if any, and

d) the class or classes of directors or employee to whom such equity shares are issued.

iii) Compliance with Rules

Where the equity shares of the Company are

a) Listed on a recognized stock exchange - Sweat equity shares are issued in accordance with the regulations made by the SEBI in this behalf;

b) Unlisted - Sweat equity shares are issued in accordance with Rules prescribed by CG.

iv) Validity of special resolution

- The special resolution authorizing the issue of sweat equity shares shall be valid for making the allotment within a period of not more than twelve months from the date of passing of the special resolution.

v) Lock in period

- Sweat equity shares issued to directors or employees shall be locked in/non-transferable for a period of three years from the date of allotment.
- The fact that the share certificates are under lock-in and the period of expiry of lock-in shall be stamped in bold or mentioned in any other prominent manner on the shares certificate.

vi) Limit on sweat equity shares

a. The company shall not issue sweat equity shares for more than 15% of the existing paid up equity shares capital in one FY or shares of the issue value of INR 5 crore; whichever is higher

b. At any time, the sweat equity shares shall not exceed 25% of the paid-up equity capital of the company.

c. A startup company, as defined in notification number GSR 180(E) dated 17th February 2016 issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India, may issue sweat equity shares not exceeding 50% of the paid-up capital upto 5 years from the date of its incorporation or registration.

vii) Valuation of Sweat Equity Shares:

- Sweat equity shares to be issued shall be valued at a price determined by a registered valuer as the fair price

giving justification for such valuation.

viii) Treatment of non-cash consideration:

Where the sweat equity shares are issued for a non-cash consideration on the basis of a valuation report in respect thereof obtained from the registered valuer, such non-cash consideration shall be treated in the following manner in the books of account of the company:

a) where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the accounting standards; or

b) where clause (a) is not applicable, it shall be expensed as provided in the accounting standards.

ix) Disclosure in the Directors' Report:

- Board of Directors shall, inter alia, disclose in the Directors' Report for the year in which such shares are issued, the specified details of issue of sweat equity shares.

Maintenance of Register:

- According to Rule 8 (14), the company shall maintain a Register of Sweat Equity Shares in Form No. SH. 3. It shall be maintained at the registered office of the company or such other place as the Board may decide.

Sweat equity shareholders to rank pari passu with other equity shareholders:

- According to Section 54 (2), 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 Section 54 and the holders of such shares shall rank pari passu with other equity shareholders.

Example

250 Equity shares offered by the company at a discount of 50% on current market price, subject to the condition that the vesting will happen on completion of minimum one year in service or achieving a particular milestone and the right being exercisable by the employee/s during a fixed duration post vesting

15. Alteration of Capital Clause [Section 61]

According to section 61 of the Companies Act, 2013, a limited company having a share capital may alter its capital clause of the memorandum.

According to the provision, a limited company having a share capital may, if so authorised by its Articles, alter its memorandum in its general meeting to—

a) Increase its authorized share capital by such amount as it thinks expedient;

b) Consolidate and divide all or any of its share capital into a larger amount than its existing shares;

However, if the consolidation and division which results in changes in the voting percentage of shareholders, the approval of the Tribunal shall be required.

c) Sub-divide whole or any part of its shares into shares of smaller amount than is fixed by the Memorandum.

d) Convert all or any of its paid- up shares into stock and reconvert that stock into fully paid shares.

e) Cancel those shares which, at the time of passing of the Resolution in that behalf have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

The cancellation of shares (also known as diminution of capital) shall not be deemed to be a reduction of share capital.

Examples

1) The authorised share capital of A Ltd. consists of 1,00,000 shares of INR 10 each. The company has already issued 1,00,000 shares. The company intends to issue fresh share capital amounting to INR 20 lakh. Before issuing the fresh shares, the company has to first increase the authorised capital u/s 61.

2) The authorised share capital of B Ltd. consists of 1,00,000 shares of INR 10 each fully paid-up. The company may consolidate and divide the shares u/s 61 such that the share capital becomes 10,000 shares of rupees 100 each fully paid up.

3) The share capital of C Ltd. consists of 1,00,000 shares of INR 10 each fully paid up. The company may convert its fully paid shares into stock u/s 61. On such conversion, C Ltd shall have a stock of INR 10 lakhs. Afterwards C Ltd may reconvert stock into shares.

4) The authorised share capital of D Ltd. consists of 1,00,000 shares of INR 10 each INR 5 paid-up. The company may sub-divide its shares into shares into shares of smaller amount u/s 61 such that the share capital becomes 10,00,000 shares of INR 1 each Re. 0.5 paid up.

5) The authorised share capital of E Ltd. consists of 1,00,000 shares of INR 10 each. The company issues the whole of the share capital to the public. However, the public subscribes to 96,000 shares only. The company may cancel the balance 4,000 shares which have not been subscribed to by the public.

Requirements of alternation of Capital Clause

i) Power in Articles

The share capital of a Company can be altered only if it so authorized by its Articles of Association.

ii) Pass Ordinary Resolution

The company must obtain the approval of members by passing an Ordinary Resolution in the general meeting of its members. For this purpose, a Board Meeting must be held to convene a general meeting of the members and all legal provisions in this regard shall be followed including the circulation of a detailed explanatory note on the proposed change along with the notice for the general meeting.

iii) Notice to ROC

Notice of such alteration along with the altered copy of MOA must be given to the Registrar within 30 days of alteration.

Note: No alteration to the Memorandum will have effect unless it has been registered with the Registrar.

16. STOCK [SEC. 61]

Meaning

- Stock means a bundle of shares expressed in a lump sum. It means the aggregate of fully paid up shares of a members merged into one fund.

Original issue not permissible

- A company cannot make an original issue of stock. Sec. 61 authorizes a company to convert its fully paid shares into stock.

Conversion of shares into stock conditions

a) The company is authorized by the Articles in this behalf.

b) The company passes an Ordinary Resolution.

c) As per sec. 64, notice of conversion of shares into stock is to be given to ROC within 30 days in the prescribed Form along with a copy of altered memorandum.

Effects of conversion of shares into stock

- Share includes stock. Accordingly, conversion of shares into stock does not affect the rights of a members in any way.
- The stock can be transferred in the same way as the shares can be transferred with the only difference that stock can be transferred in fractions.
- The register of members shall show the amount of stock held by each member instead of the shares previously held by each member.

Reconversion of stock into shares

For reconversion of stock into shares, the company shall comply with the same conditions as are required to be complied with at the time of conversion of shares into stock.

17. Further Issue of Share Capital [Sec. 62]

A rights issue refers to subscription rights offered to the company's existing security holders to buy additional securities in a company. It is a non-dilutive pro rata way to raise capital.

Example

1:8 rights issue means an existing investor can buy one extra share for every eight shares already held by him/her. Usually the price at which the new shares are issued by way of rights issue is less than the prevailing market price of the stock to encourage subscription.

Applicability of sec. 62

Sec. 62 applies to all companies having a share capital and which proposes to issue further shares.

1) Offer of further shares to existing shareholders (i.e. right shares)

A. Nature of right

Further shares shall be offered to the existing equity shareholders in proportion to the paid-up share capital held by them.

Every existing shareholder shall have a right to:

a) Accept the offer of shares offered to him; or
b) Decline the offer of shares offered to him; or
c) Renounce the share offered to him in favour of any other person.

B. Letter of offer

Shares shall be offered to the existing shareholders by sending to each of them a letter of offer. The letter of offer shall be dispatched to all the existing shareholders by:

a) Registered post; or
b) Speed post; or
c) Electronic mode courier; or
d) any other mode having proof of delivery.

The letter of offer shall specify

a) The number of shares offered; and
b) The time (minimum 15 days, and maximum 30 days) within which the offer may be accepted.

In case of a private company, if 90% of the members give their consent in writing or in electronic mode, the period lesser than minimum 15 days and maximum 30 days shall apply; and

c) A statement that if the offer is not accepted within the time specified in the letter of offer, the offer shall be deemed to have been declined; and

d) A statement that every shareholder has a right to renounce the shares offered to him to any other person (unless the Articles restrict such right).

C. Disposal of shares if offer is not accepted

The shares which remain unsubscribed by the existing shareholders may be disposed off by the Board of Directors in such manner which is not disadvantageous to the shareholders and the company.

2) Offer of further shares to employees

Further shares may be offered to the employee under Employees' Stock Option Scheme by complying with such conditions as may be prescribed.

Legal Requirements

i) Requirement of SR

The issue of ESOP scheme shall be approved by the shareholders of the company by passing SR. However, in case of a private company, instead of SR, an OR shall be sufficient.

ii) Exercise price

A company granting option to its employees pursuant to ESOP scheme will have the freedom to determine the exercise price in conformity with the applicable accounting policies, if any.

iii) Time gap

There shall be minimum period of 1 year between the grant of options and vesting of options.

iv) Lock in

The Company shall have the freedom to specify the lock-in period for the shares issued under the ESOP scheme.

v) Eligibility

An employee shall be eligible for grant of option under the ESOP scheme only if he is-

a) A permanent employee of the company who has been working in India or outside India; or

b) A director of the company, whether a whole-time director or not, but excluding an independent director; or

c) An employee as defined in clause (a) or (b) of a subsidiary in India or outside India, or of a holding company of the company, but does not include

   i) An employee who is a promoter or a person belonging to the promoter group; or

   ii) A director who, either himself or through his relative or through anybody corporate, directly or indirectly, holds more than 10% of the equity shares of the company.

   However, in case of a start-up company, as defined in Notification Number GSR 180(E) dated 17th February, 2016 issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India, the conditions mentioned in sub-clause (i) and (ii) not apply upto **10 years** from the date of its incorporation.

3) Offer of further shares to any person

Further shares may be offered to any person (whether or not those persons include the existing shareholders or employees, and whether these shares are issued for cash or for consideration other than cash), if

a) The price of such shares is determined by a registered value (however until a registered value is appointed in accordance with the provisions of the Act, the valuation report shall be made by an independent merchant

banker who is registered with SEBI or an independent chartered accountant in practice having a minimum experience of 10 years).

b) It is authorized by SR passed by the company; and

c) Conditions as may be prescribed are complied with.

Example: A listed company at Bombay Stock Exchange, intends to offer its new shares to non-members. All the existing members of the company were against the same pointing on the validity of the same. Here in the given case, section 62 (a) (iii), (b) and (c) further shares in a company limited by shares may be issued to non -members under certain circumstances. In compliance with the provision, offer of new shares to non-members is valid

4) Allotment of shares on account of conversion of loans or debenture into shares

A Company may allot shares on account of conversion of loans or debentures into shares provided that-

a) The terms of issue of such debentures or the terms of raising such loans contained a term regarding conversion of debentures on loans into shares; and

b) The terms of issue of such debenture or the terms of raising such loan were approved before the issue of such debentures or raising loan by passing SR.

5) Allotment of shares on account of conversion of loans or debentures into shares consequent to order of CG [sec. 81 (4) to (7) of the Companies Act, 1956]

A. Order of CG directing conversion

Where any debentures have been issued,

- or loan has been obtained from any Government by a company, and
- if that Government considers it necessary in the public interest,
- it may, by order, direct that such debentures or loans or any part thereof
- shall be converted into shares in the company
- on such terms and conditions as the Government finds reasonable.

CG may make such an order even if the terms of issue of such debentures or loans do not contain any provision for conversion.

The order of CG directing conversion shall be final and conclusive. However, the company may prefer an appeal to the Tribunal on the ground that the terms and conditions of conversion are not acceptable to the company.

B. Terms of conversion

The terms of conversion of such debenture of such debentures or loans shall be such as appear reasonable to CG. In determining the terms and conditions of such conversion, CG shall have due regard to the following circumstances:

a) The financial position of the company.

b) The terms of issue of the debentures or the terms of the loans.

c) The rate of interest payable on the debentures of the loans.

d) The capital of the company, its liabilities, its reserves, its profits during the preceding 5 years.

e) The current market price of the shares of the company.

C. Conditions for making order of conversion

The order for conversion can be given only if CG is of the opinion that it is necessary in the public interest to make an order of conversion of loans or debentures into shares.

D. Appeal by the company to the court

If the terms and conditions of such conversion are not acceptable to the company, the company may prefer an appeal to the Tribunal.

The appeal shall be preferred/filed within 60 days.

The decision of the Tribunal on such appeal shall be final and conclusive.

E. Alteration of memorandum of company due to increase in authorized share capital:

Where the Government has, by an order directed that any debenture or loan or any part thereof shall be converted into shares in a company and where no appeal has been preferred to the Tribunal or where such appeal has been dismissed, then the memorandum of company shall, by such order having the effect of increasing the authorised share capital of the company, stand altered and the authorised share capital of such company shall stand increased by an amount equal to the amount of the value of shares which such debentures or loans or part thereof has been converted into.

Example

A listed company at Bombay Stock Exchange, intends to offer its new shares to non-members. All the existing members of the company were against the same pointing on the validity of the same. Here in the given case, section 62 (1) (a) (iii), (b) and (c) further shares in a company limited by shares may be issued to non -members under certain circumstances. In compliance with the provision, offer of new shares to non-members is valid.

18. Bonus Issue of Shares [Section 63]

Bonus shares are fully paid shares issued proportionately by a company to its current shareholders free of any cost to them.

Example

1:3 bonus issue means an existing shareholder will get one extra free share for every three shares already held by him/her.

A. Source of issue of bonus shares

A Company may issue its fully paid-up bonus shares to its members out of:

i) Its free reserves;
ii) The securities premium account; or
iii) The capital redemption reserve account.

The section specifically clarifies that no issue of bonus shares shall be made by capitalizing reserves created by the revaluation of assets.

B. Conditions for issue

No company shall issue fully paid up bonus shares unless-

i) Issue of bonus shares is authorized by its Articles;

ii) Bonus shares can be issued only if the Board recommends such an issue.

A Company which has announced the decision of its Board recommending a bonus issue cannot subsequently withdraw the same.

iii) Issue of bonus shares has been authorized by passing ordinary resolution in the general meeting;

iv) Bonus shares must be fully paid.

v) Bonus shares are issued to existing members of the company holding fully paid shares. The partly paid-up shares, if any, outstanding on the date of allotment are made fully paid-up;

vi) It has not defaulted in payment of interest or principal in respect of fixed deposit or debt securities issued by it;

vii) It has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus;

viii) It complies with such other conditions as may be prescribed.

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

19. Notice to be given to Registrar for Alteration of Share Capital etc. [Sec. 64]

The company shall give notice to ROC in case of

i) Alteration of share capital as per sec. 61.
ii) Increase in the authorised share capital consequent to the order of the Government as per sec. 62.
iii) Redemption of preference shares as per sec. 55.
iv) Increase in the number of members by a company not having a share capital.

Procedure for giving notice

- The notice shall be given to ROC within 30 days.
- The notice shall be given in the prescribed from viz from no. SH-7.
- A copy of altered memorandum shall also be filed with ROC.

20. Purchase by a Company of its Own Shares [Section 67]

A. Prohibition on buying own shares

No Company (whether public or private) shall buy its own shares. However, the right of the Company to redeem the preference shares shall not be affected.

Exemption to private company.

A private company is allowed to buy its own shares if following conditions are satisfied:

i) No other body corporate has invested any money in the share capital of such private company

ii) The borrowings of such private company from banks or financial institutions or anybody corporate is less than twice its paid-up share capital or INR 50 crore; whichever is lower.

iii) Such a private company does not have any subsisting default in repayment of such borrowings.

B. Giving financial assistance for purchases of shares:

General rule:

- No public company shall give financial assistance for purchase of its own shares or of its holding company.
- The restriction applies to every kind of financial assistance, whether it is direct or indirect and whether it is given by way of a loan, guarantee, provision of security or otherwise.
- A private company can give financial assistance for purchase of its own shares or of its holding company.

Exceptions i.e. Public Company is allowed to give financial assistance for purchases of shares:

i) Lending of money by a banking company in the ordinary course of its business

ii) The provision of money by a company

- in accordance with any scheme approved by company through special resolution; and

- for the purchase of fully paid up shares in the company or its holding company
- being a purchase of shares by trustees
- for the benefit of the employees.

iii) The giving of loans by a company

- to persons in the employment of the company
- other than its directors or key managerial personnel
- for an amount not exceeding their salary or wages for a period of 6 months
- with a view to enabling them to purchase fully paid-up shares in the company or its holding company.

However, disclosures in respect of voting rights not exercised directly by the employees in respect of shares to which the scheme relates shall be made in the Board's report in such manner as may be prescribed. [Section 67].

Note: Nothing in Section 67 shall affect the right of a company to redeem any preference shares issued under this Act or under any previous Companies law.

Punishment for Contravention

If a company contravenes the provisions of this section, it shall be punishable with

- fine which shall not be less than one 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
  - imprisonment for a term which may extend to three years and
  - with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

21. Buy-Back of Shares [Section 68 -70]

Buy back is the re-acquisition by a company of its own securities. It is a way of returning money to its investors.

Example

Tata Consultancy Services (TCS), has recently announced India's biggest buyback offer till date. The software major plans to buy back up to 5.61 crore equity shares at INR 2,850 per share. The buyback is being made through the tender offer route, which means the existing shareholders can tender their shares through the stock exchange. The buyback offer price of INR 2,850 represents a 13.7% premium to INR 2,506.50, the closing price on February 20 when the announcement was made.

Section 68 of the Companies Act, 2013 provides the power to a Company to purchase its own securities subject to certain conditions.

A. Sources of funds for buy-back of shares:

A company can purchase its own shares or other specified securities and the purchase should be out of:

i) Its free reserves; or

ii) The securities premium account; or

iii) The proceeds of the issue of any shares or other specified securities

However, buy back of any kind of shares or other specified securities cannot be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities [section 68(1)]

Note: "Specified securities" includes employees stock option or other securities as may be notified by the Central Government from time to time.

B. Buy-back from whom?

The buy-back may be

i) from the existing shareholders or security holders on a proportionate basis; or

ii) from the open market; or

iii) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity. [section 68(5)]

C. Conditions for buy-back

Following conditions must be satisfied for buy back of shares:

i) All the shares or other specified securities for buy-back are fully paid-up.

ii) The buy-back is authorized by its Articles.

iii) Appropriate resolution authorizing the buy-back is passed by the Company.

Case I – Where buy back is authorized by passing Special Resolution	Case II – Where buy back is authorized by passing a resolution at a Board Meeting
▪ The buy-back shall not exceed 25% of aggregate paid up capital and free reserves	▪ The buy-back shall not exceed 10% of aggregate paid up equity capital and free reserves
▪ The buy-back of equity shares in any FY shall not exceed 25% of total paid up equity capital in that FY.	
▪ Notice of GM, in which SR is to be passed shall be accompanied by an explanatory statement, stating a) Full and complete disclosure of all material facts; b) The Necessity for buy-back; c) Class of securities to be bought back; d) Amount to be invested under buy back; e) Time limit for completion of buy back.	

iv) The ratio of the aggregate debts (secured and unsecured) owned by the company after buy back is not more than twice the paid-up capital and its free reserves.

v) The buy-back of the shares or other specified securities listed on any recognized stock exchange is in accordance with the regulations made by SEBI in this behalf.

vi) 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.

D. Time limit for completion of buy-back:

Every buy-back shall be completed within twelve months from the date of passing the special resolution or a resolution passed by the Board authorizing the buy-back [section 68(4)]

E. Declaration of solvency:

Where a company has passed appropriate resolution to buy back its own shares or other securities, it shall, before making such buyback offer, file with the Register, a declaration of solvency in the form as may be prescribed that it will not be rendered insolvent within a period of one year of the date of declaration by the Board.

In case of listed Company, declaration of solvency shall be filed with SEBI as well.

F. Extinguishment of securities

Where a company buys back its own securities or other specified securities, it shall extinguish and physically destroy the shares or securities so bought back within seven days of the last date of completion of buy back.

G. Cooling period:

Where a company completes a buy- back of its shares or other specified securities, it shall not make further issue of same kind of shares within period of six months except by way of

i) bonus issue or
ii) in the discharge of subsisting obligation such as
   a) conversion of warrants,
   b) stock option schemes,
   c) sweat equity or
   d) conversion of preference shares or debenture into equity share.

H. Filing of buy-back return:

A company shall, after completion of the buy back, file with the Registrar a return containing such particulars relating to the buy back within thirty days of such completion as may be prescribed.

In case of listed Company i.e. a company whose shares are listed on any recognized stock exchange; return shall be filed with SEBI as well.

21.1. Mandatory Creation of Capital Redemption Reserve account [section 69]

When buy back is made out of

- free reserves or securities premium account
- then a sum equal to the nominal value of the share so purchase
- shall be transferred to the capital redemption reserve account and
- details of such transfer shall be disclosed in the balance sheet.

Utilisation of CRR: CRR can be utilized only for issue of fully paid bonus shares to existing members.

21.2. Prohibition for buy-back in certain circumstances [Section 70]

i) Prohibition in case of defaults in payment

No company shall, directly or indirectly, buy back its own shares or other specified securities if a default is made by the company in

a) repayment of deposits; or
b) interest payment thereon; or
c) redemption of debentures or preference shares; or
d) payment of dividend to any shareholder; or
e) repayment of any term loan or interest payable thereon to any financial institutions or banking company.

ii) Prohibition in case of non-compliances

No company shall, directly or indirectly, buy back its own shares or other specified securities if it has not complied with provisions of

a) Sec. 92 (Filing of Annual Return)
b) Sec. 123 (Provisions relating to Declaration of Dividend)
c) Sec. 127 (Payment of Dividend within 30 days)
d) Sec. 129 (Provisions relating to Financial Statements)

22. Reduction of Share Capital [Section 66]

Modes of Reduction of Capital

i) Reduction in unpaid capital

The company may extinguish or reduce the liability on any of its shares in respect of share capital not paid-up.

Example

- A company has issued 10,000 equity shares of INR 10 each INR 6 paid up. The company may resolve to reduce the nominal value of its shares to INR 6 each.
- When such reduction becomes effective, the members will not be required to pay the balance liability of INR 4 per share. This is called as extinguishment of liability in respect of shares capital not paid up.
- However, if the company passes a resolution to reduce the nominal value of its shares to INR 7 each the members will not be required to pay INR 3 since the nominal value of every share shall stand reduced to INR 7. This is called as reducing liability in respect of share capital not paid-up

ii) Cancellation of lost paid up capital

Either with or without extinguishing or reducing liability on any of its shares, cancel any paid-up share capital which is lost or is unrepresented by available assets

- A company has 10,000 equity shares of INR 10 each fully paid up. The company has accumulated losses amounting to INR 80,000.
- The Company may write off loss of INR 80,000 against capital.
- If the liability is extinguished, the share capital of the company shall, henceforth, consist of 10,000 equity shares of INR 2 each fully paid up.
- If the liability is not extinguished, the share capital shall consist of 10,000 equity shares of INR 10 each, INR 2 paid-up.

iii) Paying off excess paid up capital

Either with or without extinguishing or reducing liability on any of its shares, pay off any paid-up share capital which is in excess of the wants of the company.

Examples

- A company has 10,000 equity shares of INR 10 each fully paid up. The company finds that available funds are in excess of the needs of the company. The company may return back a portion of paid up share capital, say INR 4 on every share.
- If the liability is extinguished, the share capital of the company shall consist of 10,000 equity shares of INR 6 each fully paid up.
- If the liability is not extinguished, the share capital shall consist of 10,000 equity shares of INR 10 each, INR 6 paid-up.

Legal Requirements for Reduction of Share Capital

A. Reduction of share capital by Special Resolution

Subject to confirmation by the Tribunal on an application by the company, a company

- limited by shares or
- limited by guarantee and having a share capital
- may, by a special resolution,
- reduce the share capital in any manner and in particular, may—

a) extinguish or reduce the liability on any of its shares in respect of the share capital not paid-up; or

b) either with or without extinguishing or reducing liability on any of its shares

i) cancel any paid-up share capital which is lost or is unrepresented by available assets; or

ii) pay off any paid-up share capital which is in excess of the wants of the company, alter its memorandum by reducing the amount of its share capital and of its shares accordingly.

B. Issue of Notice from the Tribunal

The Tribunal shall give notice of every application made to it to the

a) Central Government (power delegated to Regional Director),

b) Registrar,

c) Securities and Exchange Board, in the case of listed companies, and

d) the creditors of the company and

- shall take into consideration the representations, if any, made to it by them
- within a period of three months from the date of receipt of the notice.

If no representation has been received from the Central Government, Registrar, SEBI or the creditors within the said period, it shall be presumed that they have no objection to the reduction.

C. Order of tribunal

The Tribunal may, make an order confirming the reduction of share capital on such terms and conditions as it deems fit if it is satisfied that

a) the debt or claim of every creditor of the company has been discharged or determined or has been secured or his consent is obtained,

b) the accounting treatment, proposed by the company for such reduction is in conformity with the accounting standards specified in section 133, and

c) a certificate to that effect by the company's auditor has been filed with the Tribunal.

D. Publishing of order of confirmation of Tribunal

The order of confirmation of the reduction of share capital by the Tribunal shall be published by the company in such manner as the Tribunal may direct.

E. Delivery of certified copy of order to the Registrar

The company shall deliver a certified copy of the order of the Tribunal and of the minute approved by the Tribunal to the Registrar

- within thirty days of the receipt of the copy of the order, showing—

a) the amount of share capital;

b) the number of shares into which it is to be divided;

c) the amount of each share; and

d) the amount, if any, at the date of registration deemed to be paid-up on each share.

Registrar shall register the reduction of share capital and issue a certificate to that effect.

F. Liability of member after Reduction of Share

A member of the company, past or present, shall not be liable to any call or contribution in respect of any share held by him exceeding the amount of difference, if any, between the amount paid on the share, or reduced amount, if any, which is to be deemed to have been paid thereon, as the case may be, and the amount of the share as fixed by the order of reduction.

G. In case where creditor is entitled to object

Where the name of any creditor entitled to object to the reduction of share capital under this section is,

- not entered on the list of creditors
- due to his ignorance of reduction or of their nature and effect with respect to his debt or claim, and
- after such reduction,
- the company commits a default, within the meaning of section 6 of the Insolvency and Bankruptcy Code, 2016, in respect of the amount of his debt or claim-

a) every person, who was a member of the company on the date of the registration of the order for reduction by the Registrar, shall be liable to contribute to the payment of that debt or claim, an amount not exceeding the amount which he would have been liable to contribute if the company had commenced winding up on the day immediately before the said date; and

b) if the company is wound up, the Tribunal may, on the application of any such creditor and proof of his ignorance as aforesaid, if it thinks fit, settle a list of persons so liable to contribute, and make and enforce calls and orders on the contributories settled on the list, as if they were ordinary contributories in a winding up.

H. Punishment for Contravention

i) If any officer of the company

a) knowingly conceals the name of any creditor entitled to object to the reduction;
b) knowingly misrepresents the nature or amount of the debt or claim of any creditor; or
c) abets or is privy to any such concealment or misrepresentation as aforesaid,

he shall be liable under section 447.

ii) If a company fails to publish the order of confirmation of the reduction of share capital in the manner directed by the Tribunal, it shall be punishable as follows:

a) Minimum fine: INR 5 lakh
b) Maximum fine: INR 25 Lakh

I. No reduction shall be made in case of default in repayment of Deposits or interest therein:

Section further Provides that no such reduction 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.

Note: Nothing in this section shall apply to buy-back of its own securities by a company under section 68.

23. Forfeiture of Shares [Regulation 28 to 34 of Table F]

- If member fails to pay any call or installment of a call on the day appointed for payment, the Board may, at any time thereafter, serve a notice on him requiring to pay the unpaid call or installment together with any interest which may have accrued.

Legal Requirements

i) Authorisaton - Specific authorization in Articles is required.

ii) Call made - A valid call must have been made by the Company which remains unpaid.

iii) Notice of forfeiture - Before effecting forfeiture, the company is required to give notice of forfeiture to the defaulting shareholder.

The notice must clearly specify

a) The last day upto which the unpaid calls can be paid.
b) The amount payable by the shareholder.
c) A clear warning that the shares shall be forfeited in case of non- payment of calls within the time specified in notice (not being less than 14 days).

iv) Resolution for forfeiture - Board Resolution is passed for effecting a forfeiture.

v) Compliance with Articles - Forfeiture is in the nature of penal proceedings. Therefore, forfeiture is valid only if the provisions of articles are strictly complied with.

vi) Bonafide - Forfeiture must be bonafide and in the interest of the Company.

Effect of Forfeiture of Shares

i) A person whose shares are forfeited ceases to be a member.

ii) The amount already paid by the defaulting shareholder stands forfeited.

iii) The forfeiture of share does not amount to reduction of share capital.

iv) Even after forfeiture, such person continues be liable to pay to the Company, all monies which, at the time of forfeiture was payable by him in respect of forfeited shares.

Thus, the liability for unpaid calls remains even after forfeiture of shares. The liability of such person shall cease when the Company receives full payment in respect of the forfeited shares.

Note: A forfeited share may be sold on such terms and in such manner as the Board thinks fit. At any time before a sale or disposal of forfeited shares, the Board may cancel the forfeiture on such terms as it thinks fit.

Judicial decisions

- Where the Articles authorized the directors to delegate any of their powers to any committee of the Board, it was held that a resolution for forfeiture passed by such committee was valid, ***[Bhagwati Prasad v Shirmani Sugar Mills Ltd.]***
- A call which does not fix the time of payment cannot support a forfeiture. ***[Vishwanath Prasad Jalan v Hoty Land Cinetone Ltd]***
- Where forfeiture was made by the Board for the purpose of enabling a favoured member to escape from his liability, it was held to be collusive and abuse of power and also a fraud on other shareholders, and was therefore held to be invalid. ***[Re, Esparto Trading Co.]***

23.1. Reissuance of Forfeited Shares

- Shares forfeited by Company may either be cancelled or reissued to another person at the discretion of the Board. Reissue of forfeited shares is a sale of shares not amounting to an allotment.
- According to Secretarial Standard on Forfeiture of Shares, the directors would fix a price for the forfeited share that should not be lower than the amount of the call (s) due and unpaid on the share at the time of forfeiture.
- In the case of Company whose shares are listed in a recognized stock exchange, re-issue of forfeited shares shall be as per guidelines for preferential issue of the SEBI and the listing agreement.

24. Surrender of Shares

- A voluntary return of shares to the company by a shareholder is called as surrender of shares.
- A company may accept surrender of shares provided surrender has been made in such circumstances which justify the forfeiture of such shares.

25. Lien on Shares

- **Conditions for exercising lien**

Specific provision in the Articles is necessary to exercise lien on shares.

- **Effects of exercise of lien**

If the shares are subject to lien, such shares cannot be sold by the shareholders.

- **Loss of lien**

Lien is lost if the shareholder, whose shares are subject to lien, applies for transfer of such shares and the company registers such transfer of shares. In this case, the transferee's title to such shares shall be free from any lien.

26. Share Certificate [Section 46 read with Section 56]

A. Meaning of share certificate

- Certificate issued by the Company is prima-facie evidence of the fact that the person named therein is the owner of such number of shares as are specified therein.
- Issue of share certificate is mandatory for every company having share capital, whether public or private.

Note: Where the shares are held in dematerialized form, the record of the depositary is the prima facie evidence of the interest of the beneficial owner.

Note: This section does not apply to shares held by a person as a beneficial owner in depositary.

B. Legal Requirements

The share certificate shall be

a) distinguished by distinctive number; and
b) issued under the common seal of the company, which shall be affixed in the presence of, and signed by:
   i) Two directors duly authorized by the Board or Committee of the Board, if authorized by the Board; and
   ii) the secretary or any person authorized by the Board.

In case a Company does not have common seal, the share certificate shall be signed by two directors or by a director and company secretary, wherever the company has appointed company secretary.

C. Issuance of a duplicate share certificate

A duplicate share certificate can be issued if it is proved that

i) share certificate has been lost or destroyed; or

ii) it is defaced, mutilated or torn and is surrendered to the Company.

Note: In case of unlisted company, duplicate share certificate shall be issued within 3 months of submission of complete documents with the Company.

Note: In case of listed company, duplicate share certificate shall be issued within 45 days of submission of complete documents with the Company.

D. Time limit to issue share certificates

Sec 56 (4) provides that every Company shall deliver the certificates of all securities allotted

Subscribers to the memorandum	- within 2 months from the date of incorporation

Allotment of any of its shares	-	within 2 months from the date of allotment
Allotment of debentures	-	within 6 months from the date of allotment
Transfer or transmission of securities	-	within 1 month from the date of receipt of transfer deed or intimation of transmission.

Provided that where the securities are dealt with in a depository, the company shall intimate the details of allotment of securities to depository immediately on allotment of such securities.

It is noteworthy to observe that the share certificates issued by a company are comparable with the currency notes issued by the Central Bank i.e. Reserve Bank of India. Therefore, strict penal provisions are in existence against fraudulent activities. In such cases, the wrong-doer company and every officer who is in default are punishable under Section 447.

27. Prohibition on Personation of Shareholders [Sec. 57]

If any person deceitfully personates as an owner of any security and thereby

- obtains or attempts to obtain any such security or
- receives or attempts to receive any money due to any such owner
- he shall be punishable u/s 57.

Punishment for contravention

Imprisonment – Minimum; 1 year – Maximum: 3 year

Fine – Minimum INR 1 lakh – Maximum: INR 5 lakh

28. Definition and Meaning of Debentures

A. Definition [Sec 2 (30)]

Debenture includes debenture stock, bonds and any other security of the company, whether constituting a charge on the company's assets or not.

However, following instruments shall not be treated as debenture

a) the instruments referred to in Chapter III-D of the RBI Act, 1934; and
b) such other instrument, as may be prescribed by the CG in consultation with the RBI, issued by a company.

B. Meaning

Debenture means a document acknowledging a loan made to the company and

- providing for the payment of interest on the sum borrowed until the debenture is redeemed.

Example:

Sigma Computers Limited desires to borrow INR 50,00,000 from the public by issuing 7% Debentures. It is intended that each unit of debenture shall be of INR 100. Thus, it can issue 50,000 debentures of INR 100 each carrying 7% rate of interest which can be paid at the end of every quarter. If such debentures (secured by a charge on the assets of the company) are issued for six-year duration, the principal amount shall be repaid by the end of sixth year.

The terms of issue may even allow repayment of principal amount in equal yearly instalments, in which case a portion of debentures shall be redeemed on yearly basis and the company shall be required to pay interest only on the outstanding amount. The debenture holders may also be given the option of converting their debentures into equity shares at the time of maturity.

Thus, Sigma Computers Limited is able to borrow a large sum of money from different borrowers with the help of debentures and it is not required to approach a single borrower for such a big amount.

In other words, 'issue of debentures' is the most convenient way of borrowing large sums of money and at the same time the debenture holders do not exert any influence over the ownership and working of the company unless their interest is jeopardized by certain decisions.

Section 71 of Companies Act, 2013 provides the manner in which a Company may issue debentures.

29. Types of Debentures

i) Issue of Debentures with an Option to Convert:

According to Section 71 (1), a company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption.

As a pre-condition, it is provided that the issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a special resolution passed at a general meeting.

ii) Issue of secured debentures – Discussed subsequently

No voting rights: The section prohibits issue of debentures carrying voting rights i.e. No company shall issue any debenture carrying voting rights at any meeting of the company, whether generally or in respect of particular classes of business.

30. Issue of Secured Debentures

Secured debentures may be issued by a company subject to such terms and conditions as may be prescribed in Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014.

A. Maximum Time of Redemption

For companies other than infrastructure companies	Date of its redemption shall not exceed 10 years from the date of issue.
For infrastructure companies	Date of its redemption may exceed 10 years but not thirty years from the date of issue.

B. Creation of security

Such an issue of debentures shall be secured by the creation of charge on the properties or assets of the company having a value which is sufficient for the due repayment of the amount of debentures and interest thereon.

Security of debentures, by the way of charge or mortgage, shall be created in favor of the debentures trustee on:

i) Any specific movable property of the company; or

ii) Any specific immovable property, wherever situated, or any interest therein.

C. Appointment of debenture trustee

The company shall appoint a debenture trustee before

- the issue of prospectus or
- letter of offer for subscription of its debenture to
- public or its members exceeding 500

and not later than 60 days after allotment of the debentures, execute a debentures trust deed to protect the interest of the debenture holders.

31. Debenture Trustee

A. Appointment of debenture trustee

The company shall appoint debenture trustee after complying with the following conditions:

i) The names of the debenture trustee shall be stated in prospectus or letter of offer inviting subscription for debentures and also in all the subsequent notices or other communications sent to the debenture holders.

ii) Before appointment of debenture trustee, a written consent shall be obtained from such debenture trustee and a statement to that effect shall appear in the letter of offer issued for inviting subscription of the debentures.

B. Restrictions on the appointment of a debentures trustee

No person shall be appointed as debenture trustee if he

i) beneficially holds shares of the company;

ii) is promoter, director or key managerial personnel or any other officer or any employee of the company or its holding, subsidiary or associate company;

iii) is beneficially entitled to moneys which are to be paid by the company otherwise than as remuneration payable to the debenture trustee;

iv) is indebted to the company or its subsidiary or its holding or associate company or a subsidiary of such holding company;

v) has any pecuniary relationship with the company amounting to 2% or more of its gross turnover or total income of fifty lakhs rupees or such higher amount as may be prescribed; whichever is lower, during the two immediately preceding financials years or during the current financial year;

vi) has furnished any guarantee in respect of the principal debts secured by the debentures or interest thereon;

vii) is relative of any promoter or any person who is in the employment of the company as director or key managerial personnel.

32. Duties of Debenture Trustee

i) Protect the interest of debenture holders

To perform such acts as are necessary for the protection of the interest of the debenture holders and do all other acts as are necessary in order to resolve the grievances of the debenture holders.

ii) No inconsistent terms

To satisfy himself that the prospectus or letter of offer does not contain any matter which is inconsistent with the terms of the issue of debentures or with trust deed.

iii) No prejudice to the interest of debenture holders

To satisfy himself that the covenants in the trust deed are not prejudicial to the interest of the debenture holders.

iv) Communication of defaults

To communicate promptly to the debenture holders with regard to defaults, if any, in relation to payment of interest or redemption of debentures and consequent action taken by the trustee.

v) Appointment of the nominee

To appoint a nominee director on the Board of the company in the event of:

a) Two consecutive defaults in payments of interest to the debentures holder; or
b) Default in creation of security for debentures; or
c) Default in redemption of debentures.

vi) No breach of terms of trust deed

To ensure that the company does not commit any breach of the terms of issue of debentures or covenants of the trust deed and take such reasonable steps as may be necessary to remedy any such breach.

To inform the debenture holders immediately of any breach of the terms of issue of debentures or covenants of the trust deed.

vii) Implementation of creation of securities

To ensure the implementation of the conditions regarding creation of security for the debentures, if any and debenture redemption reserve.

viii) Assets are free from other encumbrances

To ensure that the assets of the company issuing debentures and of the guarantors, if any, are sufficient to discharge the interest and principal amount at all times and that such assets are free from any other encumbrances except those which are specially agreed to by the debenture holders.

ix) Reports on utilization of funds

To call for reports on the utilization of funds raised by the issue of debentures.

x) Convene the meeting of debenture holders

To take steps to convene a meeting of the holders of debentures as and when such meeting is required to be held.

33. Liability of Trustee to Debenture holders

In general, a debenture trustee is liable to debenture holders for any type of breach of trust. However, he may escape the liability in the following cases:

i) Where the trustee can show that he took such care and diligence as required of him as a trustee having regard to the powers, authorities and discretions conferred on him by the trust deed.

ii) Where a majority of debenture holders holding **not less than 3/4th in value** of debentures, present and voting in person agree at a meeting summoned for the purpose, with respect to specific acts or omissions of the trustees.

34. Debenture Redemption Reserve (DRR)

Where debentures are issued by a company under this section, the company shall

- create a debenture redemption reserve account @ **10%** value of debentures issued
- 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 for any purpose except for the redemption of debentures.

In case of listed Companies, unlisted Banking Companies NBFC and Housing Finance Companies – creation of DRR is Not Required.

Also, company shall (on or before the 30th day of April in each year) deposit minimum fifteen percent of the amount of its debentures maturing during the year in any one or more of the following methods, namely:

a) in deposits with any scheduled bank;
b) in securities of the Central Government or of any State Government;
c) in securities mentioned in section 20 of the Indian Trusts Act, 1882;

Above investments cannot be charged for securing any loan etc. Also, it should be used only for redemption of debentures.

Also, it should not at any time fall below 15% of the amount of the debentures maturing during the year ending on the 31st day of March of that year;

In case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture.

35. Other Points

1) Limit on Borrowings through Debentures:

Before the issue of debentures, the Board of Directors of the company shall obtain approval of the shareholders through special resolution if the borrowings by issuing debentures together with the amount already borrowed exceed the aggregate of company's paid-up share capital, free reserves and securities premium amount. Temporary loans obtained from the company's bankers in the ordinary course of business are not to be included in the borrowings.

2) Return of Allotment:

If a company having share capital makes allotment of any debentures (falls within the definition of 'securities'), it is required to file with the jurisdictional Registrar a Return of Allotment (Form No. PAS-3) within thirty days of such allotment.

3) Payment of interest and Redemption of debentures

A company shall pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

4) Filing of petition before the Tribunal by the debenture trustee

Where at any time the debenture trustee conclude that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amounts as and when it becomes due, the debenture trustee may file a petition before the Tribunal and the Tribunal may, by order, impose such restrictions as may consider necessary in the interest of the debenture holders.

5) On failure to redeem the debentures/ to pay interest on the debentures

Tribunal may, on the application of any or all the debenture holders or debenture trustee and after hearing the parties concerned, direct the company to redeem the debenture by paying the principal and interest due.

6) Default in compliance of order of the Tribunal

If any default is made in complying with the order of the Tribunal, every officer of the company who is in default shall be punishable with

- imprisonment for a term which may extend to 3 years; or
- fine which shall not be less than INR 2,00,000 but which may extend to INR 5,00,000 or
- with both.

7) Procedure to be prescribed by the Central Government

The Central Government may prescribe the procedure, for securing the issue of debentures, the form of debenture trust deed, the procedure for the debenture-holders to inspect the trust deed and to obtain copies thereof, quantum of debenture redemption reserve required to be created and such other matters.

36. Distinction between 'Shareholder' and 'Debenture holder'

Basis	Shareholder	Debenture holder
Status	A Shareholder is a member of a company.	A debentures holder is a creditor of the company.

Basis	Shareholder	Debenture holder
Voting Rights	A shareholder has a right to vote.	No company shall issue any debentures carrying voting rights.
Income	Shareholders are entitled to get dividend only out of profits. Thus, the income on shares is uncertain.	Debenture holders are entitled to a fixed rate of interest which the company must pay whether or not the company has made a profit.
Redemption	Except in case of redeemable preference shares, the shareholders are paid back only at the time of winding up of the company.	Debenture, unless the debentures are irredeemable, may be paid back on the expiry of the specified time.
Winding up	In the event of winding up, shareholders cannot claim payment unless all outside creditors have been paid in full.	Debenture holders, normally being secured lenders, have prior claim for repayment.
Nature of security	A share is an ownership security, non-payable during the life time the company.	Debenture is a creditorship security repayable during the life time of the company.
Charge on profit	Dividend on shares is not a charge against profit.	Interest on debentures is a charge against the profit and deducted from the revenues for the purpose of calculating tax liability.

37. Distinction between Shares and Stock

Basis	Shares	Stock
Nature	A share represents the smallest unit into which the capital of the company is divided.	Stock means a bundle of shares expressed in a lump sum. It means aggregate of fully paid up shares of a member merged into one fund.
Time of issue	Shares can be issued in the first instance i.e. original issue of shares can be made.	A company cannot issue the stock ab ignition i.e. a company make an original issue of stock. Shares, if fully paid may be converted into stock.
Paid up value	Shares may be fully paid or partly paid.	Stock shall always be fully paid.
Nominal value	A share has a nominal value.	Stock has no nominal value.
Transfer in fractions	Shares cannot be transferred in fractional amount.	Stock can be transferred in fractional amounts.
Distinctive number	Every share has a distinctive number (except in depository system).	Stock has no distinctive numbers.
Authorization for issue	No authorization in the Articles is required for issue of shares.	A company may convert its fully paid up shares into stock only if it is authorized by the Articles in this behalf.

38. Difference between Share Certificate and Share Warrant

Basis	Share Certificate	Share Warrant
Issue	Compulsory	Optional
Nature	To be issued irrespective of fully paid up or partly paid up shares.	Can be issued only if shares are fully paid up.
Type of company	Every company, whether public or private, is entitled to issue.	Only a public company is entitled to issue.
Owner of shares	A share certificates entitles the person named in it to the shares specified in the share certificate.	It entitles the bearer of the share warrant to the shares specified in the share warrant.
Negotiable	Not a negotiable instrument.	Is a negotiable instrument.

Basis	Share Certificate	Share Warrant
instrument		
Holder - whether a member	Holder is a member of the company.	Holder is not a member of company.
Power in articles	No power in the articles is required to issue a share certificate.	The articles of the company must authorize it to issue share warrants.
Payment of stamp duty on transfer	The transfer of shares attracts stamp duty where a share certificate has been issued.	No stamp duty is payable where the shares are transferred by means of delivery of share warrant.
Dividend payable to whom	Dividend is paid to the registered holder i.e., the person named in the share certificate.	Dividend is paid to the bearer of the coupons attached with the share warrants.
Original issue	A share certificate can be issued originally i.e., at the first instance.	A share warrant CANNOT be issued originally.

39. Reduction of Share Capital vs. Diminution of Share Capital

Basis of distinction	Reduction of Capital	Diminution of Capital
Reduction	Usually involves reduction of paid up capital or sometimes may involve reduction of subscribed capital.	Involves reduction of nominal capital.
Resolution	Special resolution	Ordinary resolution is sufficient.
Confirmation	Confirmation from NCLT is must.	Not applicable
Notice	Copy of order of NCLT is required to be filed with ROC.	Mere filing of notice of cancellation u/s 95 is sufficient.
Time limit for filling of notice/order	No time limits.	Within 30 days from the date of cancellation.

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-Swami Vivekanand

About CA Kishan Kumar

- ★ Kishan Kumar is an **Associate member** of The Institute of Chartered Accountants of India.
- ★ He is a **throughout Rankholder** in CA examinations.
- ★ He himself scored **Exemption in EIS-SM** in his CA Inter Exam..
- ★ He has been **awarded by Nitish Kumar, Hon'ble Chief Minister** of Bihar for his excellence in the field of education.
- ★ Internationally renowned **University of South Wales** has also felicitated him for his aptitude and achievements during his academic life.
- ★ Kishan has worked with **Ernst & Young and PwC (Big 4 Firms)** and uses his practical corporate experience to make the subject more interesting and engaging.
- ★ His students have secured **marks as high as 85** and hundreds have scored exemptions.
- ★ He is committed to make meaningful contribution to the life of promising CA aspirants.

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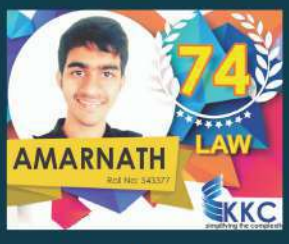

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CHAPTER 4B
TRANSFER AND TRANSMISSION OF SHARES

To change your life, you must first change your day.

1. TRANSFERABILITY OF SHARES – INTRODUCTION [SEC. 44]

Share and debenture are movable property (they are treated as goods). Shares shall be transferable in the manner laid down in the Articles and in accordance with various provisions of this Act.

Transferability of shares of Public and Private company

Public Company - Shares of public company are freely transferable.

Private Company - Shares of a private company are transferable with reasonable restrictions. However, a private company cannot impose absolute prohibition on transferability of shares.

Mode of transfer of ownership

1) **Transfer –** Voluntary transfer of shares from one person to another.
2) **Transmission –** When a person becomes entitled to shares by operation of law, it is termed as transmission.

2. REQUIREMENTS FOR TRANSFER OF SHARES [SECTION 56]

A. Transfer deed

i) Application for transfer of shares to the company must be made in a prescribed form either by the transferor or transferee of shares.

ii) This form is called 'transfer deed', 'share transfer form', 'transfer form' or 'instrument of transfer'.

iii) Instrument of transfer should be in prescribed form i.e. Form SH 4.

iv) The registration of transfer is to be done in accordance with the provisions in the Articles, if any.

B. Execution of transfer deed.

Following steps are required:

i) Instrument is to be filled with following details:

a) number of shares transferred.

b) details of shares transferred, i.e., share certificate number and distinctive number of shares.

c) name, address and occupation, if any, of the transferee.

ii) It shall be signed by the transferor and the transferee.

iii) It shall be duly stamped in accordance with Indian Stamp Act, 1899.

C. Submission of transfer deed to the company by the transferor and the transferee

Following documents are submitted with the company along with transfer deed within the prescribed time:

i) If share certificate is in existence - The share certificate is to be annexed.

ii) If no such certificate is in existence - The letter of allotment of shares is to be annexed.

Time limit for submission of transfer deed to the company.

Within sixty days from the date of such execution.

In case the transfer deed is lost or delivered to the Company after 60 days of its execution, the Company may register the transfer of shares after obtaining such indemnity as the Board may decide.

D. Transfer of partly paid shares.

If the transfer is of partly paid shares and the application for transfer is made by the transferor,

- the company shall not register the transfer unless
- it has given notice of such application to the transferee and
- the transferee makes no objection to the proposed transfer within two weeks.

The Board of Directors, on being satisfied that the above procedure has been followed, shall register the transfer.

On registration, the name of the transferor is removed from the register of members and the name of the transferee is substituted in its place.

After registration, a new share certificate is issued to the transferee within a period of one month from the date of receipt of the instrument of transfer or the intimation of transmission, by the company.

Example

Himanshu has received a notice from Chaitanya Progressive Books Private Limited on 7th August, 2019 intimating that Shefali has submitted a transfer deed duly signed by her for transfer of 500 partly paid shares (INR 6 paid- up out of Face Value of INR 10 per share) in his name. Himanshu as transferee must raise his objection to the proposed transfer of partly paid shares latest by 21st August, 2019.

In case of Government company –

It is further provided that the provisions of this sub-section [i.e. section 56(1)], in so far as it requires a proper instrument of transfer, to be duly stamped and executed by or on behalf of the transferor and by or on behalf of the transferee, shall not apply with respect to

- bonds issued by a Government company,
- provided that an intimation by the transferee specifying his name, address and occupation, if any, has been delivered to the company along with the certificate relating to the bond; and if no such certificate is in existence, along with the letter of allotment of the bond:

Provided also that the provisions of this sub-section shall not apply to a Government Company in respect of securities held by nominees of the Government.

A. Meaning

Transmission of shares means transfer of share and passing of title to another person by operation of law.

B. Reason of transmission of shares and its effect

i) **Death of a member-** When a shareholder expires, his shares need to be transmitted to his legal representative.

ii) **Insolvency of a member-** When a shareholder becomes insolvent, his shares are to be transmitted to his Official Receiver.

iii) **Lunacy:** When a shareholder becomes lunatic, his shares are to be transmitted to his administrator appointed by the Court.

C. Following are not required in case of Transmission of shares

i) No transfer form is required for transmission of shares.

ii) No stamp duty is required to be paid.

D. Right of legal representative / official assignee

The legal representative/ official assignee may decide either to

a) Register himself as the member of the company; or

b) Transfer his share by executing a transfer deed.

Legal representative becoming member of the company

In case the legal representative decides to become a member, he must send a written and signed notice called "Letter of Request" or "Letter of Intimation" to the company notifying his decision.

In this case, a company has no power to refuse registration of transmission of shares once the legal representative produces a proper evidence of his inheritance.

Legal representative transferring shares

The legal representative may sell the shares without being registered, if he does not wish to be registered as a member of the company.

All provisions relating to transfer of shares and registration of transfer will apply to such transfer.

Example

Richa Daniel, after having obtained succession certificate, succeeded to 7,000 shares of INR 100 each allotted to her late father Alexender Daniel by Speed Software Limited. To pay off the debt of her cousin Stesley, she wants to transfer whole of the 7,000 shares to her on the basis of a duly stamped instrument of transfer which has been signed by her as well as Stesley. Accordingly, she has delivered the required documents to the company for transfer of shares.

In terms of Section 56 (5), the company, on receipt of duly stamped instrument of transfer along with requisite share certificates and succession certificate, shall transfer the shares in favour of Stesley. Thus, even though Richa Daniel, the legal representative of Alexender Daniel, is not a holder of 7,000 shares as per the Register of Members of the company, the transfer effected by her in favour of her cousin Stesley is a valid transfer as if she had been the holder of securities at the time of executing the transfer deed.

Note: As an alternative, Richa Daniel may choose to get herself registered as holder of the 7,000 shares in which case, she will make an application to Speed Software Limited. Such application shall be accompanied with share certificates and succession certificate. There is no need to submit instrument of transfer or transfer deed in such a case of transmission. This is so because transfer deed cannot be signed by the deceased person as transferor.

On receipt of these documents, the company will scrutinize them and if found in order, it shall proceed to enter the name of Richa Daniel in the Register of Members. Consequently, the name of the deceased person i.e. Alexender Daniel shall be deleted. Further, new share certificates will be issued in the name of Richa Daniel, the legal representative of Alexender Daniel.

3. Difference between Transfer and Transmission of Shares

Basis	Transfer of shares	Transmission of shares
Meaning	It refers to voluntary transfer of rights, duties and liabilities of a member.	It refers to transfer of rights, duties and liabilities of a member by operation of law.
Reason	It happens when a person wants to cease his membership or decrease his number of shares held, in favour of transferee.	Death of a member, Insolvency of a member,
Consideration	A valid consideration is required.	For transmission, no consideration is required.
Stamp duty	Payable	Not payable
Transfer deed	For transfer, a valid transfer deed signed by the transferor is required.	No transfer deed is required. Only a letter of request to the company is sufficient.

4. Restriction on Transfer of Shares by a Private Company

A. Restrictions on Transfer of Shares by a Private Company

- A private company is statutorily under obligation to place certain restrictions on transferability of its shares.
- These restrictions are contained in the articles of the company and empowers the Board of Directors to restrict the right of members to transfer the shares.
- However, the grounds contained in the Article must be fair and reasonable and in the interest of the company.
- Thus, a private company can restrict but cannot prohibit the transfer of its shares.

B. Ground on which the Registration May Be Refused by a Private Company.

i) **Transferee is a rival concern –** Where the transferee belongs to a rival concern.

ii) **Transferor is indebted to the company –** Where the transferor is indebted to the company and the Articles empowers the company to refuse transfer by indebted members.

iii) **Partly paid shares to minor –** Where partly paid shares are being transferred to a minor.

iv) **Transferee is not financially capable** – Where the intended transferee is not financially capable of paying the balance calls on shares.

v) **Prejudicial to the interest of the company** – Where the intended transfer will lead to change in the management of the company which would be prejudicial to the interest of the company.

vi) **The instrument of transfer is incomplete –** Where the instrument of transfer is incomplete, or is not properly executed or properly stamped.

vii) **Offer to existing shareholders –** Where the articles stipulate that the shares cannot be transferred to an outsider if any member of the company is willing to purchase the share at a fair price.

viii) **Employee shareholders to offer shares to existing members –** Where the Articles provide that the members who are also employees of the company shall offer their shares to other members when they leave the employment in the company.

5. Restrictions on Transfer of Shares by a Public Company

i) **Not financially capable -** If partly paid shares are being transferred and transferee is known to be financially incapable of paying balance calls.

ii) **Partly paid shares to minor -** If partly paid shares are being transferred to a minor.

iii) **Calls are in arrears -** In case where calls are in arrears of the transferor.

iv) **Transferor is indebted to the company -** Where the transferor is a debtor of the company and the company has exercised lien on his shares.

v) **Invalid instrument -** If the instrument is incomplete, defective and not properly stamped.

vi) **Just and equitable grounds -** On other just and equitable ground in the interest of the company.

6. Refusal to Register Transfer or Transmission of Securities by a Private Company and Appeal against Refusal [Section 58]

A. Refusal to register the transfer or transmission by a Private Company

i) Compulsory issue of notice

If a private company limited by shares refuses to register the transfer of, or the transmission by operation of law of, any securities, it shall give notice of such refusal to

- transferor and the transferee or
- to the person giving intimation of such transmission.

ii) Time limit for sending notice

Within a period of 30 days from the date on which the instrument of transfer, or the intimation of such transmission, as the case may be, was delivered to the company.

iii) Content of notice

Notice shall contain reasons of refusal to transfer or transmission of shares.

B. Appeal against refusal

i) **Appeal to whom -** Appeal shall be filed before the Tribunal.

ii) **Appeal by whom -** Transferee or person giving intimation.

iii) **Time limit for appeal**

If notice of refusal is given by the Company	The appeal must be filed within 30 days of receipt of such notice.
If notice of refusal is not given by the Company	The appeal must be filed within 60 days of delivery of the transfer deed or the intimation of transmission.

C. Order of Tribunal

The Tribunal shall hear the appeal. The Tribunal may

i) dismiss the appeal; or

ii) direct that the transfer or transmission shall be registered by the company. The company shall comply with such order within a period of 10 days of the receipt of the order; or

iii) direct the company to pay damages, if any sustained by any aggrieved party.

D. Punishment for contravention

Any contravention of an order of Tribunal is punishable with

Imprisonment - Minimum 1 year and maximum 3 years; and

Fine - Minimum INR 10,000 and maximum 5,00,000.

7. Refusal to Register Transfer or Transmission of Securities by a Public Company and Appeal against Refusal [Section 58]

A. Free transferability of shares

The securities in a public company shall be freely transferable. Any contract or arrangement between 2 or more persons in respect of transfer of securities shall be enforceable as a contract.

B. Appeal against refusal

Appeal to whom - Appeal shall be filed before the Tribunal.

Appeal by whom - Transferee or person giving intimation.

Ground of appeal

The appeal may be filed on the ground that pubic company has, without sufficient cause, refused to

i) register the transfer of securities within 30 days from the delivery of transfer deed; or

ii) Register the transmission of securities within 30 days of the intimation of transmission.

Time limit for appeal

If notice of refusal is given by the Company	The appeal must be filed within 60 days of receipt of such notice.
If notice of refusal is not given by the Company	The appeal must be filed within 90 days of delivery of the transfer deed or the intimation of transmission.

C. Order of Tribunal

The Tribunal shall hear the appeal. The Tribunal may

i) dismiss the appeal.

ii) direct that the transfer or transmission shall be registered by the company. The company shall comply with such order within a period of 10 days of the receipt of the order.

iii) direct the company to pay damages, if any sustained by any aggrieved party.

D. Punishment for contravention

Any contravention of an order of Tribunal is punishable with

Imprisonment - Minimum 1 year and maximum 3 years; and

Fine - Minimum INR 10,000 and maximum 5,00,000.

8. Rectification of Register of Members [Section 59]

Section 59 of the Companies Act, 2013 provides the procedure for the rectification of register of members after the transfer of securities.

A. Grounds of appeal

Without sufficient cause

i) Name of any person is entered in the register of members of a company, or

ii) Name of any person is omitted from the register of members of a company, or

iii) Default or unnecessary delay takes place in entering in the register, the fact that any person has become member, or

iv) Default or unnecessary delay takes place in entering in the register, the fact that any person has ceased to be a member.

B. Who may appeal?

i) The person aggrieved; or

ii) Any member of the company; or

iii) The company.

C. Appeal to whom

- The appeal shall be filed with the Tribunal
- In case of foreign members or debenture holders residing outside India, the appeal shall be filed in a competent court in India as may be specified by CG, by way of notification.

E. Order of Tribunal

The Tribunal shall hear the appeal. The Tribunal may

i) dismiss the appeal; or

ii) direct that the transfer or transmission shall be registered by the company within a period of ten days of the receipt of the order; or

iii) direct rectification of the records of the depository or the register and in the latter case, direct the company to pay damages, if any, sustained by the party aggrieved.

F. Right to transfer not restricted

Sec. 59 shall not restrict the right of security holders to transfer such securities. Any person acquiring such securities shall be entitled to voting rights unless the voting rights have been suspended by an order of Tribunal.

9. Application to Tribunal to Set Right the Contravention of any Law[Sec 59(4)]

A. Applicability of sec. 59(4)

Where the transfer of securities is in contravention of any provision of

a) The Companies Act, 2013; or

b) SEBI Act, 1992; or

c) Securities Contracts (Regulation) Act, 1956; or

d) Any other law for the time being in force.

B. Rights conferred in sec. 59(4)

Right to make an application for rectification of register and records and to set right the contravention.

C. Application to whom?

The application should be made to Tribunal.

D. Order of Tribunal

The Tribunal may direct the company or the depository to set right the contravention and rectify its register or records.

10. Rights of Transferor and Transferee in case of Pending Registration

A. Completion of transfer

The transfer is complete only when the transferee is registered as a member in the register of members.

B. Dividend

The company must keep the dividend on such shares at abeyance and transfer the dividend to the unpaid dividend account unless the transferor authorizes the company in writing to pay the dividend to transferee.

C. Bonus and rights shares

The allotment of bonus and right shares to the transferee is also to be kept on abeyance till the shares are registered in the name of the transferee.

D. Voting rights

The transferor has voting rights but must vote as the transferee directs. However, if the transferee has not paid the full price, the transferor may vote as he pleases.

E. Call money

The transferor has to pay the calls in case of partly paid shares. However, the transferor has right to recover the same from the transferee.

F. Fraud

Where the transferor fraudulently sells his shares again to some other person, then the first purchaser on registration will be entitled to the shares in priority to 2nd purchaser.

11. Forged Transfer

A. Meaning

An instrument on which signature of the transferor is forged is called forged transfer.

B. Forgery does not confer any title

If a transfer is forged and the company registers the transfer, the true owner can apply to the company for rectification of the register of members and his name to be put on the register.

C. Forged transfer is void – ab- initio

Forged transfer is void from the very beginning.

D. Rights of parties

i) It does not confer any legal title on the transferee.

ii) The original owner continues to be the member.

iii) The true owner can get his name restored in the register of members.

iv) The company can cancel the share certificate if a company has issued a share certificate to the transferee based on forged documents.

v) If the transferee has transferred shares to an innocent buyer;

a) The company can refuse to register his transfer; and

b) Innocent buyer can claim damages from the company on the ground that he acted on the faith of the share certificate issued by the company.

c) The company may claim damages from the person who lodged the forged instrument.

Judicial decisions

1) A forged transfer does not confer any title on transferee. This is so even where a person acting innocently has taken a transfer of shares, with the transferor's signatures forged, and has got himself registered as a member in the transferor's place and has received a share certificate in his own name. ***[France v Clark]***

2) When shares are transferred by means of a forged transfer deed, the transferee does not get any right in respect of the shares. The fact that he is a bona fide purchaser for value does not make any difference. The transferee does not get any rights. The company is bound to restore to the register of members, the name of the original shareholder (purported transferor) and cancel the name of the transferee from the register of members and cancel the share certificate issued to the transferee. ***[Kaushalya Devi (Smt.) v National Insulated Cable Company of India Ltd.]***

3) Failure to reply to an intimation by the company to a shareholder that transfer of his shares is about to be made unless objected to is not negligence on the part of the shareholder. ***[Barton v London and North Western Rly. Co]***

4) An estoppel arises against the company where on the basis of a forged transfer, the company has issued a share certificate to the transferee, and some innocent third party, acting on the faith of such share certificate and for consideration, applies for transfer of shares in his name. Accordingly, the company shall have to pay damages to such innocent third party. ***[Sheffield Corporation v Barclay]***

Example

'A' commits forgery and thereby obtains a certificate of transfer of shares from a company and transfers the shares to 'B' for value acting in good faith. Company refuses to transfer the shares to 'B'. In this case company is right to refuse to do the transfer of the shares in the name of the transferee B without any liability as a forged transfer is a nullity in law and does not give the transferee concerned any title to the shares. Whereas A incurs a criminal liability under the Indian Penal Code punishable both by imprisonment and also being liable to compensate both the Company and B for losses suffered by them

12. Transfer of Shares under Depository System

- Depository Act, 1996 provides for establishment of 1 or more depositories.
- Every depository is required to be registered with SEBI and receive a certificate of commencement of business.
- Investors who want to join the system are required to be registered with 1 or more depository participants who will be agent of depositors.
- The depository participants are custodial agencies of securities like banks, financial institutions or large corporate brokerage firms.
- Upon entry in the system, share certificate of the investor will be dematerialized and his name will be entered in the books of participants as beneficial owners.
- The name of the investors in the register of members will be replaced by the name of the depository.
- The investor will continue to enjoy all the rights of a member including voting rights on his shares.
- Shares in the depository shall cease to have distinctive numbers.
- At the time of public issue, the investor can indicate his choice in application form regarding demat shares or share certificate.
- An investor may, at any time, opt out of depository system and claim share certificate from the company. Name of the investor will be re-entered in the register of members in place of the name of depository.

- Changes in the ownership are made automatically on the basis of delivery versus payment.
- There is a regular mandatory flow of information to the company regarding details of ownership in depository's record.
- Any loss caused by negligence of the depository or participant is to be indemnified by the depository.

Benefits of Depository System

i) **Fast -** Under physical form, the transfer of shares can take upto 1 month. Under depository system, the shares are transferred by the depository immediately on receipt of the authorization.

ii) **Economical -** The transfer of shares proves economical since printing, safe custody and dispatch of transfer deed and share certificate is not required.

iii) **Paperless working -** The share certificates are not required to be issued under the depository system. Also, transfer deed is not required to be executed. This ensure saving of paper.

iv) **Saving of human efforts -** There used to be a lot of human efforts in effecting transfer of shares under physical form. Under depository system, the transfer of shares takes place in electronic form, thus saving a great deal of human effort.

v) **Overcoming frauds -** Under physical system, frauds used to take place due to circulation of forged share certificate. Under depository system, this problem has come to an end since the practice of issue of share certificate has been put to an end.

vi) **Saving of stamp duty -** No stamp duty is payable where shares are dematerialised or transferred in dematerialised form. This helps the investors in minimising the costs of transfer and at the same time promotes the business in the stock market.

13. Nomination of Shares [Section 72]

- **Applicability & Optional**

  It is applicable to all type of companies. Nomination is optional for the shareholders or debenture holders.

- **Nomination by whom**

  Every shareholders or debenture holders of a company may, at any time, nominate a person to whom his shares or debentures of the company shall vest in the event of death.

- **Joint shareholders**

  Where the shares or debentures are held by more than 1 person jointly, the joint holders may together nominate, in the prescribed manner, a person to whom all the rights in the shares or debentures of the company shall vest in the event of death of all the joint holders.

- **Prescribed form**

  The nomination shall be made in the prescribed from (Form SH 13) in duplicate with the company. One copy shall be returned to the shareholder or debenture holder, as the case may be.

- **Minor as a nominee**

  Where the nominee is a minor, the shareholder or debenture holder, as the case may be, may also appoint an adult to act as the guardian of minor during his minority.

- **Nominee to be individual only**

  The nominee can be an individual only. Thus, a society, trust, body corporate, firm, karta of HUF or a holder of power of attorney cannot be nominee.

Note: The nomination may be made by the member at any time.

- **Variation or cancellation**

At any time, a nomination may be

a) Cancelled in the prescribed manner (viz. filing Form No. SH-14)

b) Varied in the prescribed manner (viz. filing Form No. SH-14).

Consequences in case of death

i) Entitlement for shares or debentures

Nominee will automatically become entitled to such shares or debentures in the event of death of the shareholders or debentures holders. In case of joint holding, nominee will become entitled to such shares or debentures in the event of the death of all the right holders.

ii) Discretion of nominee on the death of the shareholders

a) Get himself registered as a member of the company.

Where the nominee elects to be registered as a member, then he shall send to the company, a written notice conveying his decision along with the death certificate of the deceased shareholders or debenture holder, as the case may be.

b) Transfer such shares or debentures in favour of any other person. All the provisions applicable to Transfer of securities shall be applicable in this case.

iii) Nominee entitled for dividend

On the death of the shareholder, the nominee becomes entitled to receive dividends on such shares. However, he is not eligible to exercise the other rights of membership unless he gets himself registered as a member.

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-Swami Vivekanand

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- ★ He himself scored **Exemption in EIS-SM** in his CA Inter Exam..
- ★ He has been **awarded by Nitish Kumar, Hon'ble Chief Minister** of Bihar for his excellence in the field of education.
- ★ Internationally renowned **University of South Wales** has also felicitated him for his aptitude and achievements during his academic life.
- ★ Kishan has worked with **Ernst & Young and PwC (Big 4 Firms)** and uses his practical corporate experience to make the subject more interesting and engaging.
- ★ His students have secured **marks as high as 85** and hundreds have scored exemptions.
- ★ He is committed to make meaningful contribution to the life of promising CA aspirants.

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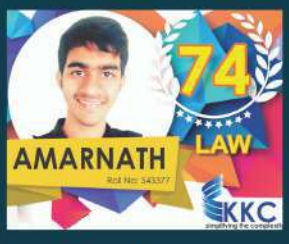

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CHAPTER 5
ACCEPTANCE OF DEPOSITS

The earlier you start working on something, the earlier you will see results.

1. INTRODUCTION

Acceptance of deposits from the members as well as public at large are an important source of finance for the corporate sector. It is, therefore, necessary to control the companies which invite deposits in order to safeguard the general and wider interest of all those persons who provide deposits out of their precious savings.

The statutory provisions as contained in sections 73 to 76A of the Companies Act, 2103 (hereinafter referred to as 'the Act') and the Companies (Acceptance of Deposits) Rules, 2014 (hereinafter referred to as 'the Rules') govern the acceptance of deposits and also renewal thereof.

A. Meaning of Deposit [2(31)]

Deposit includes any receipt of money

i) By way of deposit or loan or in any other form by a Company
ii) But does not include such companies as may be prescribed in consultation with the Reserve Bank of India.

- The above definition of 'deposit' is inclusive one.
- It includes any money received by way of:
  a) deposit; or
  b) loan; or
  c) in any other form.
- Repayment of 'deposit' is time-bound.
- It can be secured or unsecured.
- A private company can accept deposits from its members only.
- A public company can accept deposits from its members and also from the public if it fulfills certain parameters.

B. Amounts Not Considered as Deposit?

"Deposit" includes any receipt of money by way of deposit or loan or any form by a company, but does not include:

i) Any amount received from the

a) Central Government or a State Government;
b) Any other source whose repayment is guaranteed by the Central Government or State Government;
c) Local authority;
d) Statutory authority constituted under an Act of Parliament or a State Legislature;
e) Foreign Governments;
f) Foreign/ international banks;
g) Multilateral financial institutions;
h) Foreign Government owned development financial institutions;
i) Foreign export agencies;
j) Foreign collaborators;
k) Foreign body corporate and foreign citizens;
l) Person resident outside India subject to the provision of Foreign Exchange Management Act, 1999.

ii) Any amount received as a loan or facility from any banking company or Firm notified by the Central Government or from a Co-operative bank.

iii) Any amount received as a loan or financial assistance from public financial institutions notified by the Central Government in this behalf, in consultation with the Reserve Bank of India, Regional Financial Institutions, Insurance Companies, Scheduled Banks as defined in the Reserve Bank of India Act, 1934.

iv) Any amount received against issues of commercial paper or any other instrument issued in accordance with the guidelines or notification issued by the Reserve Bank of India[1].

v) Any amount received by a company from any other company.

vi) Any amount received and held pursuant to an offer made in accordance with the provision of the Act

- towards subscription to any securities
- including share application money or advance towards allotment of securities pending allotment.

vii) Any amount received from a person who, at the time of receipt of the amount, was a Director of the company or a relative of the director of a private company.

The director or a relative of the director of a private company from whom money is received, furnishes to the company, at the time of giving the money, a declaration in writing to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting loans or deposits from others.

viii) Any amount raised by the issue of bonds or debentures

ix) Any amount received in the course of or for the purposes of the business of the company

a) As an advance for the supply of goods or provision of services, provided that such advance is appropriated against supply of goods or provisions of service within a period of 365 days from acceptance of such advance.

In case of any advance, which is subject matter of any legal proceedings before any court of law, the said time limit of 365 days shall not apply.

b) As an advance received in connection with consideration for property under an agreement or arrangement, provided that such advance is adjusted against the property in accordance with the terms of agreement or arrangement.

c) As security deposit for the performance of the contract for the supply of goods or provisions of services.

[1] Commercial paper (CP) is an unsecured money market instrument issued in the form of promissory note.

d) As advance received under long term projects or for supply of capital goods except those covered under item (b) above.

If the amount received under (a), (b), (c) and (d) above becomes refundable (with or without interest) because the company accepting the money does not have necessary permission or approval to deal in the goods or properties or services for which the amount received, shall be deemed to be a deposit under these Rules.

x) Any amount brought in by the promoters of the company by way of unsecured loan in pursuance of the stipulated of any lending financial institution or a bank subject to fulfillment of the following conditions:

a) The loan is brought in pursuance of the stipulated imposed by the lending institutions on the promoters to contribute such finance; and

b) The loan is provided by the promoters themselves or by their relatives or by both; and

c) The exemption under this sub clause shall be available only till the loans of financial institutions or bank are repaid and not thereafter.

xi) any amount accepted by a Nidhi company in accordance with the section 406 of the Act.

xii) any amount received by way of subscription in respect of a chit under the Chit Fund Act, 1982

xiii) any amount received by the company under any collective investment scheme in compliance with regulations framed by the Securities and Exchange Board of India

xiv) an amount of twenty-five lakh rupees or more received by a start-up company, by way of a convertible note (convertible into equity shares or repayable within a period not exceeding five years from the date of issue) in a single tranche, from a person.

xv) any non-interest-bearing amount received or held in trust.

2. Prohibition of Acceptance of Deposit [Section 73(1)]

Acceptance of deposits is prohibited except

i) From the **members through ordinary resolution**; or

ii) From the **public by "eligible company"** being a public company, subject to conditions specified in Rules.

Exception/Exempted Companies

This restriction with respect to the acceptance or renewal of deposit from public shall not apply to the following companies:

a) Banking company,

b) Non- banking financial company as defined in the Reserve Bank of India Act, 1934,

c) Housing finance company registered with the National Housing Bank established under the National Housing Bank Act, 1987, and

d) Such other companies, as the CG may specify, after consultation with the Reserve Bank of India.

3. Kinds of Deposits

A. Acceptance of deposit from members (section 73)

i) Any company (whether private or public) can accept deposits from its members subject to the passing of a **ordinary resolution** in general meeting and subject to certain specified conditions.

ii) In order to accept deposit from members, the company has to certify in circular that it has not committed any default in the repayment of deposits accepted either before or after the commencement of this Act and where a

default had occurred, the company made good the default and a period of five years had lapsed since the date of making good the default.

B. Acceptance of deposit from the public (section 76)

i) Only an eligible public company having a

- net worth of not less than INR 100 Crores; **or**
- turnover of not less than INR 500 crores

can accept deposits from the public.

ii) Such kind of public company, for the purpose of this chapter, shall be referred to as the eligible company.

4. Eligible Company

"Eligible company" means a public company

i) having a net worth of not less the 100 crore rupees **or**
ii) a turnover of not less 500 crore rupees; **and**
iii) which has obtained the prior consent of the members in GM by means of **special resolution**; and
iv) Filing with ROC: also filed the said resolution with the registrar of companies.

However, an eligible company, which is accepting deposits within the limits specified under section 180 (1)(c), may accept deposits by means of an **ordinary resolution.**

5. Maximum amount of Deposit from Members

- The amount of deposits outstanding together with the amount of deposits proposed to be accepted shall not exceed 35% of the aggregate of the paid-up share capital, free reserves and securities premium account of the Company.
- A specified IFSC public company and a private company may accept from its members monies not exceeding 100% of aggregate of the paid-up share capital, free reserves and securities premium account.
- The maximum limit in respect of deposit to be accepted from members shall not apply to following classes of private companies;

i) A private company which is a start -up for 5 years from the date of its incorporation.
ii) A private company which fulfills all of the following conditions.
   a) It is not an associate or a subsidiary company of any other company;
   b) The borrowing of such a company from banks or financial institution or anybody corporate is less than twice of its paid-up share capital or INR 50 crore, whichever is less; and
   c) Such a company has not defaulted in the repayment of such borrowing subsisting at the time of accepting deposits under section 73.

6. Tenure of Deposit

Tenure of Deposit

- No company shall accept or renew any deposits which is repayable on demand or which is repayable within a period of less than 6 months or more than 36 months from the date of acceptance of such deposit.

Example:

A, a member of the company has deposited INR 1,00,000 with his company on 1st April, 2019. The earliest repayment date in this case shall be 30th September, 2019 and the latest repayment date shall be 31st March, 2022. Thus, the tenure will range between six months and thirty-six months, as per the policy of the company.

- **Exception:** A company may, for the purpose of meeting any of its short-term requirement of funds, may accept short term deposit which are repayable on demand or upon receiving a notice or which is repayable within a period of less than 6 months from the date of acceptance of such deposit subject to the condition that-

  i) Such deposit shall not exceed 10% of the aggregate of the paid-up share capital, free reserves and securities premium account; and

  ii) Such deposit is repayable not earlier than 3 months from the date of acceptance of such deposits.

- All companies accepting deposits shall file the details of monies so accepted with the registrar in form DPT- 3.

7. Conditions for Acceptance of Deposits from Members [Sec. 73(2)]

A company may accept deposits from its members-

- on such terms and condition as may be agreed between the company and the members
- subject to the fulfilment of the following conditions.

7.1. Resolution and Rules

An **ordinary resolution** is passed in GM.

The company shall comply with such Rules ass may be prescribed by CG.

7.2. Advertisement and Circulars

A. Issue of circular by every company referred to in sub- section (2) of section 73

i) Every company, referred to in sub section (2) of section 73, intending to invite deposit from its members shall issue a circular to all its members by

- registered post with acknowledgement due; or
- speed post; or
- electronic mode in Form DPT-1.

ii) In addition to issue of such circular to all members in the manner specified above, the circular may be published in English language in an English newspaper and in vernacular language in a vernacular newspaper having wide circulation in the state in which the company is registered.

iii) The circular shall show

a) financial position of the company
b) credit rating obtained
c) total number of depositions and
d) amount due towards deposits in respect of any previous deposits accepted by the company.

Note: Such Circular shall be issued on the authority and in the name of Board of Directors of the company.

B. A copy of circular to be delivered to the registrar

At least 30 days before the date of such issue, a copy of circular in the form of advertisement signed by a majority of the directors (or their agents duly authorized by them in writing) must be delivered to the Registrar for registration.

C. Issue and Effective dates:

The date on which the advertisement appeared in the newspaper shall be taken as the date of the issue of advertisement.

Further, the effective date of issue of circular shall be the date on which the circular was dispatched.

D. Validity of Circular

The advertisement shall remain valid till the earliest of the following dates:

a) up to six months from the closure of the financial year in which it is issued; or

b) the date on which the financial statements are laid before the company at the Annual General Meeting (AGM), or in case no AGM has been held, the latest day on which the AGM should have been held as per the relevant statutory provisions.

A fresh circular shall be issued, in each succeeding financial year, for inviting deposits during that financial year.

Deposit Receipt:

Within a period of **twenty-one days** from the date of receipt of money or realization of cheque or date of renewal, the company is required to furnish a deposit receipt to the depositor or his agent.

The receipt shall be signed by the duly authorised officer and state the date of deposit, the name and address of the depositor, the amount of deposit, the rate of interest and the maturity date.

7.3. Deposit Repayment Reserve Account

The company shall,

- **on or before 30th April each year**,
- deposit in a scheduled bank in a separate bank account, a sum equal to
- **20%** of the amount of deposit maturing **during the financial year.**

Such amount shall not at any time fall below twenty percent of the amount of deposits maturing during the financial year.

7.4. Certification of no Default

The company shall certify that it has not defaulted repayment of any deposit or interest thereon deposits *and where a default had occurred, the company made good the default* ***and a period of 5 years had lapsed since the date of making good the default.***

7.5. Creation of Security

Every company inviting secured deposits shall

- within 30 days from the date of acceptance
- provide for security by way of
- a charge on its **tangible assets** by the way of **either mortgage or hypothecation only.**

Total value of security should not be less than the amount of deposits accepted and interest payable thereon. The market value of assets subject to charge shall be assessed by a registered valuer.

If the company does not secure the deposits or secures them partially, then such deposits shall be termed as unsecured deposits in every Circular, Form, Advertisement or document through which the deposits are invited or accepted.

Note: The security for deposits shall be created in favour of a trustee for the depositor on specific movable and immovable property of the company.

Note: The security shall **not be in the nature of a pledge.**

7.6. Miscellaneous

A. Deposit in joint names (Rule 3)

Where depositors so desire, deposit may be accepted in joint names not exceeding three. A joint deposit may be accepted with or without any of the clauses, namely, "Jointly", "Either or Survivor", "First named or Survivor", "Anyone or Survivor". These clauses operate on maturity.

Example:

A, B and C have jointly deposited INR 1,00,000 in a Company.

a) In case of 'Jointly' clause, the repayment of deposit on maturity shall be made to all the three together i.e. A, B and C or the survivors.

b) In case of 'Either or Survivor' clause, the repayment of deposit on maturity shall be made to either of the three i.e. either A or B or C or the survivor.

c) In case of 'First named or Survivor' clause, the repayment of deposit on maturity shall be made to the first named person i.e. A if he is the first named person or the survivor.

d) In case of 'Anyone or Survivor' clause, the repayment of deposit on maturity shall be as in the case of 'Either or Survivor'.

B. Maximum interest or brokerage for deposits (Rule 3)

No company shall invite or accept or renew any deposit in any form, carrying a rate of interest or pay brokerage thereon at a rate exceeding the maximum rate of interest or brokerage prescribed by the Reserve Bank of India for acceptance of deposit by non-banking financial companies.

C. Premature Repayment of Deposits:

After the expiry of six months but before the actual date of maturity, if a depositor requests for premature repayment, the rate of interest payable shall be one percent less than the rate which would be payable for the period for which the deposit has actually run.

In this respect it is to be noted that the period for which the deposit has run, if it contains any part of the year which is less than six months then it shall be excluded; otherwise if that part is six months or more it shall be taken as one year.

Reduction of rate of interest is not applicable in the following cases:

a) Where the deposit is prematurely repaid to comply with Rule 3 i.e. premature repayment made in order to reduce the total amount of deposits to bring it within the permissible limits; or

b) Where the deposit is prematurely repaid to provide for war risk or other related benefits to the personnel of naval, military or air forces or to their families during the period of emergency declared under Article 352 of the constitution.

D. Premature Closure of Deposit to Earn Higher Rate of Interest:

In case a depositor desires to avail higher rate of interest by renewing the deposit before its actual maturity date, the company shall pay him the higher rate of interest only if the deposit is renewed for a period longer than the unexpired period of deposit.

E. Return of deposits to be filed with the registrar (Rule 16)

Every company to which these Rules apply shall,

- on or before the 30th day of June, of every year,
- file with the registrar
- a return in form DPT-3 along with the fee as prescribed; and
- furnish the information contained therein as on the 31st day of march of that year duly audited by the auditor of the company.

F. Disclosures in the financial statement (Rule 16A)

i) Every company, other than a private company, shall disclose in its financial statement, by way of notes, about the money received from the director.

ii) Every private company shall disclose in its financial statement, by way of notes, about the money received from the directors, or relatives of directors.

G. Nomination:

Every depositor may nominate any person at any time. The nominee shall be the person to whom his deposits shall vest in the event of his death.

H. Deposit Receipt:

Within a period of twenty-one days from the date of receipt of money or realization of cheque or date of renewal, the company is required to furnish a deposit receipt to the depositor or his agent. The receipt shall be signed by the duly authorised officer and state the date of deposit, the name and address of the depositor, the amount of deposit, the rate of interest and the maturity date.

8. Acceptance of Deposits from Public by Eligible Companies [Sec. 76 r/w sec. 73(1)

Only eligible company can invite deposit from public.

8.1. Conditions for Acceptance of Deposit from Public

A. Compliance of sec. 73(2)

The company shall comply with all the legal requirements contained in sec. 73(2) i.e. conditions for accepting deposits from the members.

B. Passing of Resolution

Eligible company is required to obtain the prior consent of the members in GM by means of special resolution

However, an eligible company, which is accepting deposits within the limits specified under section 180 (1)(c), may accept deposits by means of an ordinary resolution.

C. Compliance with Rules

The company shall comply with such Rules as may be prescribed by CG in consultation with RBI.

D. Rating of deposit

- The company shall obtain rating with respect to its deposits from a recognised credit rating agency.
- The rating shall include the net worth of the company, liquidity and ability of the company to repay the deposit on the due date.
- The rating given to the company shall be informed to the public at the time of inviting deposits.
- The rating shall be obtained every year during the tenure of deposits.

E. Advertisement of circular

All the provisions applicable to Acceptance of Deposits from member applies in this case as well. Additionally, such circular shall be placed on the website of the Company, if any.

8.2. Maximum Amount of Deposits in case of Eligible Companies

- **From Members -** 10% of the aggregate of the paid-up share capital, free reserves and securities premium account.

- **From Public -** 25% of aggregate of the paid-up share capital, free reserves and securities premium account of company.

No Government Company eligible to accept deposit u/s 76 shall accept or renew any deposit if the deposits outstanding as on the date of acceptance or renewal exceeds 35% of the aggregate of its paid -up share capital, free reserves and securities premium account of the Company.

9. Interest on Deposit and Failure to Repay Interest and Deposit

A. Interest on deposit [Section 73(3)]

Every deposit accepted by a company under sub section (2) shall be repaid with interest in accordance with the terms and conditions of the agreement referred to in that sub section.

B. Rule 17- Penal rate of interest

Every company shall pay a penal rate of interest of 18% per annum for the overdue period in case of deposits, whether secured or unsecured, matured and claimed but remaining unpaid.

C. Failure to repay deposit or interest under section 73(4)

When a company fails to repay the deposit or part thereof or any interest thereon under subsection (3), the depositor concerned may apply to the Tribunal for an order

- directing the company to pay the sum due or
- for any loss or damages incurred by him as a result of such non-payment and
- for such others as the Tribunal may deem it.

10. Punishment for Contravention of Section 73 or 76 [Sec 76A]

- Where a Company accepts or invites deposit in contravention of the manner or the conditions prescribed u/s 73/76 or Rules made thereunder; **or**

- If a company fails to repay the deposit or part thereof or any interest due thereon within the time specified u/s 73/76 or Rules thereunder or such further time as may be allowed by the Tribunal u/s 73,

a) The company shall, in addition to payment of amount of deposit or part thereof and the interest due,
   - be punishable with
   - fine which shall be ₹ 1 crore or twice the amount of deposits, whichever is lower.
   - but which may extend to INR 10 cr.

b) Every officer of the company who is in default shall be punishable with
   - imprisonment which may extend to 7 years **and**
   - with fine which shall not be less than INR 25 lakhs but which may extend to INR 2 cr. or
   - with both.

Punishment for willful default [proviso to sec. 76A]

If it is proved that officer of the company who is in default has contravened such provision knowingly or willfully with the intention to deceive the company or its shareholders or depositors or creditors or tax authorities,

- he shall be liable for action u/s 447.

11. Appointment of Trustee for Depositors [Rule 7]

Before issuing a circular or advertisement inviting secured deposits, every company shall appoint

- one or more trustees for depositors for creating security for the deposits

- after receiving a written consent from the trustee before their appointment and
- a statement that the trustees have given their consent for their appointment
- shall appear in the circular or circular in the form of advertisement with reasonable prominence.

The company shall execute a deposit trust deed in Form DPT-2 at least seven days before issuing the circular or circular in the form of advertisement.

No person including a company that is in the business of providing trusteeship services shall be appointed as a trustee for the depositors, if the proposed trustee—

a) is a director, key managerial personnel or any other officer or an employee of the company or of its holding, subsidiary or associate company or a depositor in the company;

b) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;

c) has any material pecuniary relationship with the company;

d) has entered into any guarantee arrangement in respect of debts secured by the deposits or interest thereon;

e) is related to any person specified in clause (a) above.

Removal of Trustee

Trustee for depositors can be removed from office after the issue of circular or advertisement and before the expiry of his term only with the consent of all the directors present at a meeting of the Board.

In case the company is required to have independent directors, at least one independent director shall be present in such meeting of the Board.

12. Register of Deposits [Rule 14]

Every company accepting deposits shall maintain, at its registered office, one or more separate registers for deposits accepted or renewed, containing the following particulars for each depositor:

a) name, address and PAN of the depositor/s;
b) particulars of guardian, in case of a minor;
c) particulars of the nominee;
d) deposit receipt number;
e) date and the amount of each deposit;
f) duration of the deposit and the date on which each deposit is repayable;
g) rate of interest on such deposits and the date on which the payment of interest shall be paid to the depositor;
h) particulars of security or charge created for repayment of deposits;
i) any other relevant particulars.

Time limit for making entries in Register: Within seven days from the date of issuance of the receipt duly authenticated by a director or secretary of the company or by any other officer authorised by Board for this purpose.

Preservation of Register: Period of not less than eight years from the financial year in which the latest entry is made in the register.

ARISE AWAKE AND STOP NOT TILL YOUR GOAL IS ACHIEVED

-Swami Vivekanand

About CA Kishan Kumar

- ★ Kishan Kumar is an **Associate member** of The Institute of Chartered Accountants of India.
- ★ He is a **throughout Rankholder** in CA examinations.
- ★ He himself scored **Exemption in EIS-SM** in his CA Inter Exam..
- ★ He has been **awarded by Nitish Kumar, Hon'ble Chief Minister** of Bihar for his excellence in the field of education.
- ★ Internationally renowned **University of South Wales** has also felicitated him for his aptitude and achievements during his academic life.
- ★ Kishan has worked with **Ernst & Young and PwC (Big 4 Firms)** and uses his practical corporate experience to make the subject more interesting and engaging.
- ★ His students have secured **marks as high as 85** and hundreds have scored exemptions.
- ★ He is committed to make meaningful contribution to the life of promising CA aspirants.

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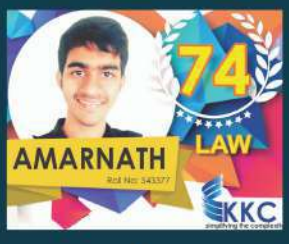

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CHAPTER 6
CHARGES

Impossible is not a fact. It is an opinion.

1. MEANING [SECTION 2(16)]

Charge means any

- interest or lien
- created on the property or assets of a Company or any of its undertakings; or both
- as security and includes a mortgage.

Further, where in a transaction for value, both parties evidence the intention that the property, existing or future, shall be made available as security for the payment of a debt, there is a charge.

Once charge is registered and filed, it becomes an information in public domain as to how much company has borrowed against its assets and from whom. The law with respect to the registration of charges are dealt in sections 77 to 87 of the Companies Act, 2013.

2. KINDS OF CHARGES

i) Fixed charge

A fixed charge is one which is created on some definite or specific property of a permanent nature.

Example – Building, land, machinery etc.

Although the company retains possession of the property so charged, it cannot sell such property without the consent of the charge holder.

ii) Floating charge

A floating charge is a charge on

- a class of assets which may be present or future and
- which changes from time to time in the ordinary course of business.

Thus, it is an equitable charge on assets which is not a specific charge on any property of the company.

Example – Stock-in trade, debtors etc.

The company can deal with the property subject to a floating charge in any manner it likes. Thus, permission of money lender is not required for disposing it or converting it into some other assets.

Example: A retail showroom will contain numerous articles kept for sale. The owner of the showroom might have

borrowed against the security of all those goods in the showroom. But he may still sell or otherwise deal with them in the ordinary course of business. The buyer will get it free of the charge.

Example: In case of a company which manufactures leather goods, the raw material in the form of leather, which is subject matter of floating charge, may be used to manufacture leather goods without seeking any permission from the lender.

A company can even create a fixed charge on the property already subject to floating charge without consent of the charge holders and the registered mortgagee will have priority over floating charge.

A floating charge remains dormant until the undertaking charged ceases to be a good concern or until the person in whose favour the charge is created intervenes.

A floating charge can be created only by an incorporated body. It is created by a deed and must be registered with Registrar of companies.

3. Difference between Fixed Charge and Floating Charge

Basis	Fixed charge	Floating charge:
Nature	It is legal charge.	It is an equitable charge.
Types of assets	It is a charge on specific, ascertained and existing asset.	It is a charge on present and future assets. Charge is not created on any specific assets.
Consent of holder	Company cannot deal with the assets except with the consent of the charge holder.	Company is free to use or deal with the assets the way it likes until the charge becomes fixed.
Priority	Fixed charge always has priority over floating charges.	Ambulatory and shifting in character.

4. Crystallization of Floating Charge

A floating charge crystallizes and becomes fixed in the following circumstances:

i) When the company goes into liquidation.

ii) When a receiver is appointed.

iii) When the company ceases to carry on the business.

iv) When the default is made in paying the principal and/or interest and the holder of the charge brings an action to enforce his security.

Effect of crystallization

Once the floating charge crystallizes, the creditors covered under the charge become entitled to be paid out of the assets comprised in the charge, in priority to all other liabilities, except the following:

i) The preferential payments. E.g. rates, taxes, wages etc.

ii) Hire purchase vendors until the goods are paid in full, even though the hire purchase agreement may have been entered into after creation of the floating charge.

5. Duty to Register Charges, etc. [Section 77]

A. Following types of Charges must be registered with registrar of companies

i) A charge for the purpose of securing any issue of debentures.

ii) A charge on uncalled share capital of the company.

iii) A charge on any immovable property.

iv) A charge on any book debts of the company.

v) A charge, not being a pledge, on any movable property of the company.

vi) A floating charge on the undertaking or any property of the company including stock in trade.

vii) A charge on the ship or any share in the ship.

viii) A charge on calls made but not paid.

ix) A charge on goodwill, or a patent or a license under a patent, or a trade mark or a license under a trade mark, or a copyright or a license under a copyright.

However, a charge created by **operation of law** or created by an **order or decree of the Court** on the aforesaid item shall not require registration.

Similarly, the application of Section 77 shall not be made to certain charges which are prescribed in consultation with the Reserve Bank of India.

B. Registration of Charges

i) Registration by the company creating a charge: It shall be duty of the company creating a charge within or outside India, on its property or assets or any of its undertakings, whether tangible or otherwise and situated in or outside India, to register the particulars of the charge.

Thus, charge may be created within India or outside India. The subject-matter of the charge i.e. the property or assets or any of company's undertakings, whether tangible or non-tangible, may be situated within India or outside India. But in each case when charge is created it must be registered by the company.

In case a charge is created by deposit of title deeds (normally banks agree for this mode of charge instead of proper mortgage), it should also be registered by the borrowing company.

ii) Registration by the charge-holder: Section 78 (explained later) provides that in case the company creating a charge fails to register the charge within the prescribed period of 30 days, the person in whose favour the charge is created can get the charge registered.

iii) Registration by the purchaser: Section 79 (explained later) covers another case of registration of charge where a company purchased some property in whose case a charge was already registered. In this case also, the company purchasing the property shall get the charge registered in its name in place of seller in the records of Registrar.

C. Verification of Instrument of Charge

A copy of every instrument evidencing any creation or modification of charge and required to be filed with the Registrar shall be verified as follows-

a) **Property situated outside India -** Verified by a certificate issued either
   i) under the seal, if any, of the company, or
   ii) under the hand of any director or CS of the company or an authorised officer of the charge holder or
   iii) under the hand of some person other than the company who is interested in the mortgage or charge;

b) **Property situated in India -** Verified by a certificate issued under the hand of any director or company secretary of the company or an authorised officer of the charge holder.

Thus, in case the instrument or deed relates solely to a property situated outside India, the copy may also be additionally verified by a certificate issued under the hand of some person other than the company who is interested in the mortgage or charge. This type of verification is not possible when the instrument or deed relates to the property situated in India, whether wholly or partly.

D. Registration of Charges by Company

The charge should be registered by Company with Registrar of Companies **within 30 days** of creation of charge.

If charge is not registered within 30 days of creation of charge, the Registrar may, on an application by the company, allow such registration to be made-

- within a period of **sixty days of such creation**, on payment of such additional fees as may be prescribed:

If the registration is not made within sixty days of such creation,

- the Registrar may, on an application,
- allow such registration to be made within a further period of sixty days after payment of such advalorem fees as may be prescribed.

Procedure for Extension of Time Limit:

For seeking extension of time, the company is required to make an

- application to the Registrar in the prescribed form
- supported by a declaration from the company signed by its company secretary or a director that
- such belated filing shall not adversely affect the rights of any other intervening creditors of the company.

The application so made must satisfy the Registrar that the company had sufficient cause for not filing the particulars and the instrument of charge, if any, within the original period of thirty days. Only then he will allow registration of charge within the extended period.

Further, **requisite additional fee or advalorem fee,** as applicable, must also be paid.

E. Issue of certificate of registration by Registrar:

If a charge is registered with the Registrar, a certificate of registration of such charge shall be issued in Form CHG-2 to the company and, as the case may be, to the person in whose favour the charge is created.

The certificate so issued by the Registrar shall be conclusive evidence that the requirements of Chapter VI of the Act and the rules made thereunder as to registration of creation of charge have been complied with.

F. Subsequent Registration not to prejudice Rights of Charge-holder

It is provided that any subsequent registration of a charge (i.e. registered within the extended period instead of original thirty days) shall not prejudice any right acquired in respect of any property before the charge is actually registered by the company.

In other words, rights of the lender or charge-holder shall not get affected and shall remain as they were before the actual registration (i.e. rights acquired from the date of creation of charge) even if the charge is actually registered within the extended period.

6. Registration of Charge by Charge Holder [Sec. 78]

- Where a company fails to register any charge within 30 days of its creation, the charge holder may make an application to the Registrar for registration of charge.
- The application shall be made in such form, in such manner and within such time as may be prescribed.
- The Registrar shall give notice of such application to the company.
- The Registrar may, within 14 days, allow the registration of the charge on payment of such fees as may be prescribed.
- The Registrar shall not allow the application of the charge holder if
  - The company itself registers the charges; or
  - The company shows sufficient cause that the charge should not be registered.

Recovery of fees: In case registration is effected on application made by the holder of charge, such person shall be entitled to recover from the company the amount of any fees or additional fees paid by him to the Registrar for the purpose of registration of charge.

7. Effect of Registration of Charge

Deemed notice of Charge [Sec. 80]

Where any charge on any property or assets of a company or any of its undertakings is registered under section 77, any person acquiring such property, assets, undertakings or part thereof or any share or interest therein shall be deemed to have notice of the charge from the date of such registration.

This provision has cautionary effect. Thus, every person needs to be cautious or careful when he desires to acquire any asset or property of a company and must enquire whether such asset or property is subject to any charge by going through the record of charges maintained at the office of Registrar of Companies before entering into the transaction.

He shall be deemed to have notice of charge from the date of its registration. In case he enters into the transaction without making any enquiry and later on suffers loss because of charge, he cannot succeed against the company for incurring loss, for it shall be deemed that he had notice of charge.

Date of Notice of Charge = Date of registration of the charge.

Example

Vishnu Marketing Limited obtained a term loan of INR fifty lacs from Beta Commercial Bank Limited by creating a charge on one of its office buildings and the charge was duly registered. Later on, if the building is sold to Neeraj, he is deemed to have notice of such charge.

In other words, it is presumed that Neeraj knew beforehand that the building was mortgaged to the bank for obtaining a loan. He cannot plead against such presumption by contending that he did not know about the charge if he suffers any loss at a later date because of the mortgage.

Effect of non-registration

Failure to register any charge, which should be registered, within the prescribed time period has the following consequences:

i) The charge would be void against the liquidator appointed under this Act or the Insolvency and Bankruptcy Code 2016, as the case may be, and the other creditors.

ii) The debt, in respect of which the charge is created, remains valid as an unsecured debt.

iii) When a charge becomes void for non-registration, no rights of lien can be claimed on the documents of title as they are only ancillary to and delivered pursuant to the charge.

But this shall not prejudice any contract or obligation for the repayment of the money secured by a charge. This means that the debt is valid and may be enforced against the company through the courts by filing a suit, but the security is lost.

Further, it may be noted that failure to register charge shall not absolve a company from its liability in respect of any offence under this Chapter.

Another important consequence of non-registration is that the charge-holder loses priority. Any subsequent registration of a charge (i.e. even if it is registered within the extended period instead of original thirty days) shall not prejudice any right acquired in respect of any property before the charge is actually registered.

Example:

Bank A has advanced Rs. One Crore to Akash Limited against the security of the company's land and building at Mulund. The charge was created by deposit of title deeds on 1st June 2019. The company did not register the charge within 30 days. Subsequently, the charge was registered on 13th August 2019 after payment of ad valorem fees and proving sufficient cause.

In the meantime, Bank B has advanced Rs. Two Crore to Akash Limited against the security of the same property on 20th June 2019. This charge was duly registered on 27th June 2019.

Subsequently, Akash Limited goes into liquidation and the property realises only Rs. Two crores.

Now, Bank B will receive its loan back fully, but Bank A will not realise anything. Because, the subsequent registration of the charge in favour of Bank A will not prejudice the right of Bank B which obtained its right before the charge in favour of Bank A was actually registered. Thus, Bank B gets priority over Bank A even though its charge was created later.

8. Section 77 To Apply In Certain Matters [Section 79]

Section 79 of the Act covers two situations as given below. In both the cases, another registration (in place of existing one) becomes necessary and the provisions contained in sec 77 relating to registration of charge shall equally apply.

A. Company acquiring any Property subject to Charge [Section 79 (a)]

In case of a property where charge is already registered and if it is sold with the permission of the holder of charge, it shall be the duty of the company acquiring it to get the charge registered in accordance with Section 77.

In other words, the earlier charge should get vacated and, in its place, new charge should get registered by the company which has acquired it.

B. Modification of Charge when there is Change in Terms and Conditions, etc. [Section 79 (b)]

Section 79 (b) requires any modification in charge (i.e. change in terms and conditions or change in extent of any charge, etc.) to be registered by the company in accordance with Section 77.

'Modification' includes variation in any of the terms and conditions of the agreement including change in rate of interest which may be by mutual agreement or by operation of law.

Variation in extent or operation of any charge is also a kind of modification. Even if the rights of a charge holder are assigned to a third party, it will be regarded as a modification.

Some other examples of 'modification' are as under:

1. where the charge is modified by varying any terms and conditions of the existing charge through an agreement;
2. where the modification is in pursuance of an agreement for enhancing or decreasing the limits;
3. where the modification is by ceding a pari passu charge;
4. where there is change in rate of interest (other than bank rate);
5. where there is change in repayment schedule of loan; (not applicable in case of working loans which are repayable on demand); and
6. where there is partial release of the charge on a particular asset or property.

C. Issue of Certificate of Modification

As per Rule 6, where the particulars of modification of charge is registered under section 79, the Registrar shall issue a certificate of modification of charge in Form CHG-3.

The certificate so issued by the Registrar shall be conclusive evidence that the requirements of Chapter VI of the Act and the rules made thereunder as to registration of modification of charge have been complied with.

9. Company To Report Satisfaction Of Charge [Section 82]

1. Intimation regarding Satisfaction of Charge

Section 82 of the Act of 2013, requires a company to give intimation of payment or satisfaction in full of any charge earlier registered, to the Registrar in the prescribed form14. The intimation needs to be given within a period of 30 days from the date of such payment or satisfaction.

Extended period of intimation: Proviso to Section 82 (1)16 extends the period of intimation from thirty days to three hundred days. Accordingly, it is provided that the Registrar may, on an application by the company or the charge holder, allow such intimation of payment or satisfaction to be made within a period of three hundred days of such payment or satisfaction on payment of prescribed additional fees17.

2. Notice to the Holder of Charge by the Registrar

On receipt of intimation, the Registrar shall cause a notice to be sent to the holder of the charge calling upon him to show cause within such time as specified in the notice but not exceeding 14 days, as to why payment or satisfaction in full should not be recorded.

If no cause is shown by the charge-holder, the Registrar shall order entering of a memorandum of satisfaction in the register of charges kept by him and accordingly, he shall inform the company of having done so.

However, no notice is required to be sent, in case the intimation to the Registrar in this regard is in the specified form and signed by the holder of charge.

If any cause is shown by the charge-holder, the Registrar shall record a note to that effect in the register of charges and inform the company.

3. No Effect of Section 82 on the Powers of the Registrar

According to sub-section (4), Section 82 shall not be deemed to affect the powers of the Registrar to make an entry in the register of charges under section 83 or otherwise than on receipt of an intimation from the company i.e. even if no intimation is received by him from the company.

4. Issue of Certificate

As per Rule 8 (2), in case the Registrar enters a memorandum of satisfaction of charge in full, he shall issue a certificate of registration of satisfaction of charge in Form No. CHG-5.

10. Power of Registrar to Record Satisfaction of Charge [Section 83]

Section 83 of the Act of 2013 empowers the Registrar to make entries with respect to the satisfaction and release of charges even if no intimation has been received by him from the company.

Accordingly, with respect to any registered charge if an evidence is shown to the satisfaction of Registrar that the debt secured by charge has been paid or satisfied in whole or in part or that the part of the property or undertaking charged has been released from the charge or has ceased to form part of the company's property or undertaking, then he may enter in the register of charges a memorandum of satisfaction that:

a) the debt has been satisfied in whole or in part; or
b) the part of the property or undertaking has been released from the charge or has ceased to form part of the company's property or undertaking.

This power can be exercised by the Registrar despite the fact that no intimation has been received by him from the company.

Intimation to affected parties

Within 30 days of recording satisfaction of charge in the register of charges, the Registrar shall inform the affected parties regarding recording of satisfaction of charge.

Certificate of registration of satisfaction of charge

Where the Registrar registers satisfaction of charge in full in pursuance of section 82 or 83, he shall issue a certificate of registration of satisfaction of charge.

11. Intimation of Appointment of Receiver or Manager [Sec 84]

Section 84 of the Act of 2013 is about the appointment of a receiver or manager and of giving intimation thereof to the company and the Registrar.

Accordingly,

- if any person obtains an order for the appointment of a receiver or a person to manage the property which is subject to a charge, or

- if any person appoints such receiver or person under any power contained in any instrument,

he shall give notice of such appointment to the company and the Registrar along with a copy of the order or instrument within 30 days from the passing of the order or making of the appointment.

In turn, the Registrar shall, on payment of the prescribed fees, register particulars of the receiver, person or instrument in the register of charges.

On ceasing to hold such appointment20, the person appointed as above shall give a notice to that effect to the company and the Registrar. In turn, the Registrar shall register such notice.

12. Punishment for Contravention [Sec 86]

According to section 86 (1) of the Act of 2013, if a company contravenes any of the provisions relating to the registration of charges or modification or satisfaction of charges, the punishment shall be as under:

- the company shall be punishable with minimum fine of ` one lakh and maximum fine of ` ten lakhs; and
- every defaulting officer of the company shall be punishable with imprisonment maximum up to six months or with minimum fine of ` twenty- five thousand and maximum of ` one lakh, or with both.

With the insertion of sub-section (2), section 447 relating to 'punishment for fraud' also becomes applicable in certain cases. Accordingly, if any person willfully furnishes:

- any false or incorrect information; or
- knowingly suppresses any material information; which is required to be registered under section 77,

he shall be liable for action under section 447.

13. Rectification by Central Government of Register of Charges [Sec 87]

Rectification in Register of Charges

Section 87 of the Act of 2013 and Rule 1223 empowers the Central Government to order rectification of Register of Charges in the following cases of default:

i) when there was omission in giving intimation to the Registrar with respect to payment or satisfaction of charge within the specified time;

ii) when there was omission or mis-statement of any particulars in any filing previously made to the Registrar. Such filing may relate to any charge or any modification of charge or with respect to any memorandum of satisfaction or other entry made under Section 82 (Company to report satisfaction of charge) or Section 83 (Power of Registrar to make entries of satisfaction and release).

Before directing that the 'time for giving the intimation of payment or satisfaction shall be extended' or the 'omission or mis-statement shall be rectified', the Central Government needs to be satisfied that such default was accidental or due to inadvertence or because of some other sufficient cause or it did not prejudice the position of creditors or shareholders.

The application in Form CHG-8 shall be filed by the company or any interested person and order of rectification shall be made by the Central Government on such terms and conditions as it deems just and expedient.

"According to Rule 12 of the Companies (Registration of Charges) Rules, 2014:

The Central Government may on an application filed in Form No. CHG-8 in accordance with section 87-

a) direct rectification of the omission or misstatement of any particulars, in any filing, previously recorded with the Registrar with respect to any charge or modification thereof, or with respect to any memorandum of satisfaction or other entry made in pursuance of section 82 or section 83,

b) direct extension of time for satisfaction of charge, if such filing is not made within a period of three hundred

days from the date of such payment or satisfaction."

14. REGISTER OF CHARGES

14.1. Registrar's Register of Charges [section 81]

Registrar shall, in respect of every company, keep a register containing particulars of the charges registered in such form and in such manner as may be prescribed.

The particulars of charges maintained on the Ministry of Corporate Affairs portal (www. mca.gov.in/MCA21) shall be deemed to be the register of charges for the purposes of section 81 of the Act.

14.2. Company's Register of Charges [section 85]

Every company shall keep, at its registered office, a register of charge and enter therein all charges on the undertaking or on any property of the company. Following details are giving in relation to each charge:

i) A short description of the property charged;
ii) The amount of the charges; and
iii) the names of the persons entitled to the charge.

Points to Note

a) The entries in the register of charges maintained by the company shall be made after the creation, modification or satisfaction of charge, as the case may be.

b) Entries in the register shall be authenticated by a director or the secretary of the company or any other person authorised by the Board for the purpose.

c) The register of charges shall be preserved permanently and the instrument creating a charge or modification thereon shall be preserved for a period of 8 years from the date of satisfaction of charge by the company.

Register to be kept open for inspection

The register of charges must be kept open

- at the registered office
- for at least 2 hours every working day during business hours
- for inspection by any creditor or member of the company without fee and
- by any other person on payment of prescribed fee.

In case of default

On refusal of the said inspection, the company and every officer of the company who is in default, shall be punishable with fine which may extend to INR 500 and with a further fine which may extend to INR 200 every day during which the refusal continues.

Note: This section shall not apply to such charges as may be prescribed in consultation with Reserve Bank of India.

ARISE AWAKE AND STOP NOT TILL YOUR GOAL IS ACHIEVED

-Swami Vivekanand

About CA Kishan Kumar

- ★ Kishan Kumar is an **Associate member** of The Institute of Chartered Accountants of India.
- ★ He is a **throughout Rankholder** in CA examinations.
- ★ He himself scored **Exemption in EIS-SM** in his CA Inter Exam..
- ★ He has been **awarded by Nitish Kumar, Hon'ble Chief Minister** of Bihar for his excellence in the field of education.
- ★ Internationally renowned **University of South Wales** has also felicitated him for his aptitude and achievements during his academic life.
- ★ Kishan has worked with **Ernst & Young and PwC (Big 4 Firms)** and uses his practical corporate experience to make the subject more interesting and engaging.
- ★ His students have secured **marks as high as 85** and hundreds have scored exemptions.
- ★ He is committed to make meaningful contribution to the life of promising CA aspirants.

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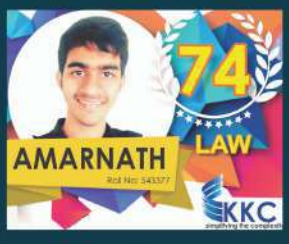

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CHAPTER 7A
MANAGEMENT & ADMINISTRATION I
(REGISTERS AND RETURNS)

Stay Hungry, Stay Foolish

1. REGISTERS OF MEMBERS ETC. [SEC 88]

Every company shall keep and maintain the following registers:

i) Register of members (separately indicating each class of equity and preference share held by every member, whether residing in India or outside India, from the date the due of registration of the company

ii) Register of debenture- holders

iii) Register of any other security holders

in such form and manner, as may be prescribed by CG.

Note: The register and index of beneficial owners maintained by a depository shall be deemed to be the registers maintained by the company.

Particulars to be contained in register of members in case of a company having no share capital

i) Name and address (registered office address in case the member is a body corporate); email address permanent account number or CIN; unique identification number if any, father's/ mother's/ spouse's name, occupation, nationality, in case member is a minor, name of the guardian and the date of birth of the member's name and address of nominee;

ii) Date of becoming member

iii) Date of cessation

iv) Amount of guarantee, if any

v) Any other interest if any; and

vi) Instructions if any given by the member with regard to sending of notices etc.

Time period for entries in registers maintained u/s 88: Within 7 days of the date of approval by the Board or Committee thereof by approving the allotment or transfer as the case may be.

Note: Register and Index of Beneficial Owner is maintained by a Depository in its record book electronically.

Maintenance of register of debenture holders: [Section 88(1)(b)]

Every company which issues or allots debentures or any other security shall maintain a separate register for

debenture holder or security holder in Form– MGT–2.

Updation of rewards of members:

Any changes relating to the status of the member or debenture-holder or any other security holder; whether due to death or insolvency or change of name or due to transfer to Investor Education Protection Fund or due to any other reason, entries shall be made in the respective registers.

Details of Nominations in the register:

Form MGT - 1 and MGT - 2 require details of nomination as referred to in section 72 of the Act, to be entered in the Register of members and register of debenture-holders or other security holders as the case may be.

1.1. Index of Members [Sec 88(2) & (3)]

- Every register required to be maintained u/s 88 shall include an index of names entered in respective registers; provided Company has 50 members or more than 50 members.
- The index shall, in respect of each member, contain sufficient indications so that entries relating to that member in the register can be readily found.
- The index shall, at all times, be kept at the same place as the register of member.
- **Register index of beneficial owner to be maintained of a depository: [Section 88(3)]**

  Register and index of beneficial owners maintained by a depository under section 11 of the Depositories Act, 1996, shall be deemed to be the corresponding register and index for the purposes of this Act.

1.2. Foreign Register [Sec 88(4)]

Maintenance of foreign register: Section 88(4) read with Rule 7 entitles a company to maintain a foreign register of members, debenture-holders or other security holders or beneficial owners, showing the holding of persons residing outside India.

Compliances: The compliances with respect to maintenance of foreign register are as follows:

- A company which has share capital or which has issued debentures or any other security may, if so authorised by its articles, keep in any country outside India, a part of the register of members or as the case may be, of debenture holders or of any other security holders or of beneficial owners, resident in that country.
- The company shall, within 30 days from the date of the opening of any foreign register, file with the RoC notice of the situation of the office in the prescribed from Form No. MGT – 3 along with the fee where such register is kept; and in the event of any change in the situation of such office or of its discontinuance, shall, within 30 days from the date of such change or discontinuance, as the case may be, file notice with the RoC of such change or discontinuance.
- A foreign register shall be deemed to be part of the company's register ('principal register') of members or of debenture-holders or of any other security holders or beneficial owners, as the case may be.
- The foreign register shall be maintained in the same format as the principal register.
- A foreign register shall be open to inspection and may be closed, and extracts may be taken therefrom and copies thereof may be required, in the same manner, as is applicable to the principal register, except that the advertisement before closing the register shall be inserted in at least two newspapers circulating in the place wherein the foreign register is kept.
- If a foreign register is kept by a company in any country outside India, the decision of the appropriate competent authority in regard to the rectification of the register shall be binding.
- Entries in the foreign register maintained under section 88(4) shall be made after the Board of Directors or its duly constituted committee approved the allotment or transfer of shares, debentures or any other securities, as the case may be.

- The company shall –
    - Transmit to its registered office in India, a copy of every entry in any foreign register within 15 days after the entry is made; and
    - Keep at such office a duplicate register for all the purposes of this Act, be deemed to part of the principal register.
    - Subject to the provisions of section 88 and the rules made thereunder, with respect to duplicate registers, the shares or as the case may be, debentures or any other security, registered in any foreign register shall be distinguished from the shares or as the case may be, debentures or any other security, registered in the principal register and in every other foreign register; and no transaction with respect to any shares or as the case may be, debentures or any other security, registered in a foreign register shall, during the continuance of that registration, be registered, be registered in any other register.
- The company may discontinue the keeping of any foreign register, and thereupon all entries in that register shall be transferred to some other foreign register kept by the company outside India or to the principal register.

Penalty on failure to maintain register as per Section 88(1) and 88(2): [Section 88(5)]

- Company and every officer of the company who is in default shall be punishable with fine which shall not be less than INR 50,000 but which may extend to INR 3,00,000 and where the failure is a continuing one, with a further fine which may extend to INR 1,000 per day.
- **Nature of offence:** The offence under this section is a compoundable offence under section 441 of the Act.

Example 1

Mr. Zoey purchased the shares of Luxy Hairstyles Private Limited, at market price, in the name of his daughter, Mila, who is 4 years old. Mr. Joe, the Director of the Company, has approached you to advise him on the updation of said change in the register of members, since Mila, being a minor is incompetent to contract in her capacity.

Answer

Since, the minors are not competent to enter into any contract, thus their names cannot be entered in the register of members. Therefore, Mr. Joe is advised that while filing MGT – 1 and MGT – 2, the names of the minor can only be entered only if the details of the guardian are present. Thus, Zoey's name shall appear in the register of members of Luxy Hairstyles Private Limited since Mila is a minor.

Example 2

Mrs. And Mr. Taneja, recently got married and jointly purchased the shares of New Hopes India Private Limited on 14th August 2018. Mr. Taneja intimated the company that only the name of his wife should appear in the records of the company, for the shares purchased by them. The secretary of the company is not sure whether this is possible, given that the shares are held in the names of both the persons.

Answer

Joint holders of shares may request the company to enter their names on the register in a certain order, or execute transfers to have their holding split, with the result that part of the holding is entered showing the name of one holder and part showing the name of another.

However, the condition of Mr. Taneja that only the name of his wife should appear in the register as a member cannot be catered to, although the names can be entered in the order such that the name of his wife appears first.

The reason for this is that the articles of most companies provide that seniority shall be determined by the order in which the names stand in the register of members.

2. Declaration in respect of Beneficial Interest in Shares [Sec 89]

For the purposes of this section and section 90, beneficial interest in a share includes,

- directly or indirectly, through any contract, arrangement or otherwise,
- the right or entitlement of a person alone or together with any other person to -
  i) exercise or cause to be exercised any or all of the rights attached to such share; or
  ii) receive or participate in any dividend or other distribution in respect of such share.

A. Declaration by registered holder of shares

If the name of a person is entered in the register of members as a holder of any shares in the company, but
- he does not hold any beneficial interest in such shares,

Then he shall file a declaration with the company
- in such form and manner as may be prescribed
- specifying the particulars of the person who holds beneficial interest in such shares
- within a period of 30 days from the date on which his name is entered in the register of members.

B. Declaration by person holding beneficial interest in shares

If the name of a person is not entered in the register of members as a holder of any shares in the company, but
- he holds any beneficial interest in such shares,

Then he shall file a declaration with the company specifying
- the nature of his interest,
- Particulars of the person in whose name the shares have been registered and
- other prescribed particulars
- within 30 days after acquiring such beneficial interest in the shares of the company.

C. Declaration in case of change in beneficial interest

If any change occurs in the beneficial interest in any shares for which a declaration had been filed u/s 89 then,
- within 30 days of such change
- a declaration in such form and containing such particulars shall be filed with the company by
  a) the person in whose name the shares have been registered and
  b) the person holding beneficial interest in such shares.

D. Filing of return by the company with the Registrar

Where any declaration is filed with a company u/s 89, the company shall-
- make a note of such declaration in the relevant register; and
- within 30 days file a return in the prescribed form with the registrar.

Note: Nothing contained above shall apply in relation to a trust which is created, to set up a Mutual Fund or Venture Capital Fund or such other fund as may be approved by the Securities and Exchange Board of India.

E. Company's duty to pay dividend not affected

Nothing contained in this section shall prejudice the obligation of the company to pay dividend to its members. On payment of dividend by the company, the company's obligation shall stand discharged.

F. Penalty for default under section 89(5) & 89(7)

Two kinds of penal provisions are included under section 89:

- **Related to persons required to make a declaration:** Section 89(5) applies to those who are required to make a declaration, but fail to do so.

The penalty for their failure, without any reasonable explanation, is fine which extends upto INR 50,000 and additionally INR 1,000 per day during which the failure continues.

- **Related to company:** Section 89(7) refers to the company which fails to comply with provisions of section 89.

  It makes punishable the company and every defaulting officer with a fine which shall not be less than INR 500 but which may go up to INR 1,000 with further fine of INR 1,000 per day during which the failure continues.

- **Exemption to Government Company -** Section 89 shall not apply to a government company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar.

Example

Ms. Emma gifted the shares purchased by her of the Company Bio-Optics Limited, to her sister Cathy. Emma had purchased these shares on the occasion of her birthday in February 2017. However, neither Emma nor Cathy were aware that they had to intimate about the transaction of transfer of such shares as a gift, to the company. Discuss the same in light of the provisions of section 89 of the Act.

Answer

The provisions of the section 89 of the Act, dealing with declaration of beneficial interest in shares by a person to the company does not apply in a civil suit where the title of the shares is in a dispute. Where the shares are gifted away, they become the property of the donee. Hence, the provisions relating to declaration of beneficial interest are not applicable.

3. Significant Beneficial Owner [Section 90]

Declaration by SBO

(1) Every INDIVIDUAL,

- who acting alone or together, or through one or more persons or trust,
- including a trust and persons resident outside India,
- holds (directly or indirectly) beneficial interests,
- of not less than 25% or such other percentage as may be prescribed (10%),
- in (a) shares of a company or (b) voting rights or (c) distributable dividend, or
- the actual exercising of (d) significant influence or control as defined in section 2(27),
- over the company (herein referred to as "SBO"),
- shall make a DECLARATION to the company, (in Form BEN-1)
- specifying the nature of his interest and other particulars,
- in such manner and within such period of acquisition of the beneficial interest or rights and any
- change thereof, as may be prescribed.

Register of SBO

(2) Every company shall maintain a REGISTER (in Form BEN-3) of the interest declared by individuals under sub-section (1) and changes therein which shall include the name of individual, his date of birth, address, details of ownership in the company and such other details as may be prescribed.

(3) The register maintained under sub-section (2) shall be open to inspection by any member of the company on payment of such fees as may be prescribed.

Return of SBO

(4) Every company shall file a RETURN of SBOs (in Form BEN-2) of the company and changes therein with the Registrar containing names, addresses and other details as may be prescribed within such time, in such form and manner as may be prescribed.

(4A) Every company shall take necessary steps to identify an individual who is a significant beneficial owner in relation to the company and require him to comply with the provisions of this section.

Notice to identify SBO

(5) A company shall give NOTICE (in Form BEN-4), in the prescribed manner, to any person (whether or not a member of the company) whom the company knows or has reasonable cause to believe -

a. to be a SBO of the company;
b. to be having knowledge of the identity of a SBO or another person likely to have such knowledge; or
c. to have been a SBO of the company at any time during the 3 years immediately preceding the date on which the notice is issued,

and who is not registered as a significant beneficial owner with the company as required under this section.

(6) The information required by the notice under sub-section (5) shall be given by the concerned person within a period not exceeding 30 days of the date of the notice.

(7) Application to Tribunal The company shall –

a. where that person fails to give the company, the information required by the notice within the time specified therein; or
b. where the information given is not satisfactory,

apply to the Tribunal within a period of 15 days of the expiry of the period specified in the notice, for an order directing that the shares in question be subject to restrictions with regard to transfer of interest, suspension of all rights attached to the shares and such other matters as may be prescribed.

(8) On any application made under sub-section (7), the Tribunal may, after giving an opportunity of being heard to the parties concerned, make such order restricting the rights attached with the shares within a period of 60 days of receipt of application or such other period as may be prescribed.

(9) The company or the person aggrieved by the order of the Tribunal

- may make an application to the Tribunal
- for relaxation or lifting of the restrictions placed under sub-section (8),
- within a period of **one year from the date of such order.**

However, if no such application has been filed within a period of one year from the date of the order under sub-section (8),

- such shares shall be transferred, without any restrictions,
- to the authority constituted under section 125(5), in such manner as may be prescribed."

(9A) The Central Government may make rules for the purposes of this section.

Penalty for not making declaration

(10) If any person fails to make a declaration as required under sub-section (1), he shall be punishable with

- imprisonment for a term which may extend to one year or
- fine which shall not be less than one lakh rupees but which may extend to ten lakh rupees or
- both and

where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the failure continues

(11) If a company, required to maintain register under sub-section (2) and file the information under sub-section (4), or required to take necessary steps under sub-section (4A), fails to do so or denies inspection as provided therein, the company and every officer of the company who is in default shall be punishable with

Fine	
Minimum	**Maximum**
INR 10 lakhs	INR 50 lakhs
If continuing offence, further fine of INR 1,000 per day after the first day during which failure continues.	

Nature of offence: The offence under this section is a compoundable offence under section 441 of the Act.

(12) If any person willfully furnishes any false or incorrect information or suppresses any material information of which he is aware in the declaration made under this section, he shall be liable to action under section 447.

- **Exemption to Government Company -** Section 89 shall not apply to a government company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar.

4. Power to close Register of Members or Debenture Holders or Other Security Holders [Sec 91]

Maximum period of closer	a) Maximum – 45 days in a year b) Maximum – 30 days at any one time
Notice of closure	a) Previous notice of the closure of register shall be given by the company. b) The notice shall be of i) At least 7 days (i.e. at least 7 days before the first day of closure); or ii) Such lesser period for listed companies as may be specified by SEBI. c) The notice shall be given in such manner as may be prescribed.
	In case of Listed Company or intends to get its securities listed, i) At least seven days previous notice by ➢ advertisement in at least ➢ a vernacular newspaper in the principal vernacular language of the district and having a wide circulation in the place where the registered office of the company is situated, and ➢ at least once in English language in an English newspaper circulating in that district and having wide circulation in the place where the registered office of the company is situated. ii) publish the notice on the website as may be notified by the Central Government and on the website, if any, of the Company. **Note:** Private companies have been exempted from issuing public notice in newspapers, provided it issues 7 days' notice to its members before effecting closure of the registers.
Penalty for contravention	For every day during which the register is kept closed in contravention of sec. 91 the company and every officer of the company who is in default shall be liable to a penalty of INR 5,000 subject to a maximum of INR 1 lakh.

5. Annual Return [Sec 92]

The section is particularly important from the compliance point of view, since this is an annual compliance and essentially captures all the important events that have taken place in the company during the financial year.

Material date for annual return	▪ Every company shall prepare an annual return in the prescribed form. ▪ The annual return shall contain the particulars as they stood on the close of FY.
Contents of annual return	a) The address of registered office of the company, its principal business activities and the particulars of its holding, subsidiary and associate companies. b) Its shares, debentures and other securities and shareholding pattern. c) Its members and debenture holders and change in the members and debenture holders since the close of the previous FY. d) Its promoters, directors and key managerial personnel and changes in directors and key managerial personnel since the close of the previous FY. e) Meeting of members or a class thereof and of the Board and its various committees and attendance details. f) Aggregate amount of remuneration of directors and key managerial personnel. g) Penalty or punishment imposed on the company directors or officers and details of compounding of offences and appeals made. h) Such other matters as may be prescribed.
Signing of annual return	a) The annual return shall be signed by i) A director; and ii) The company secretary (if there is no company secretary, then by a company secretary in practice). b) In the case of OPC, small company and start -up private company, it shall be signed by the company secretary, or if there is no company secretary then by one director. This relief is applicable if no default is committed in filing its financial statements under section 137 or annual return under section 92 of the Act, with the Registrar.
Certification of annual return	a) The annual return shall be certified by a company secretary in practice, in case of i) a listed company; or ii) any company having paid up capital or turnover of such amount as may be prescribed. b) It shall be stated by way of certification that i) the annual return discloses the facts correctly and adequately; and ii) the company has complied with all the provisions of this Act.
Time limit for filing	▪ The annual return shall be filed with the registrar within 60 days from the date on which AGM is held. ▪ If the AGM for any year is not held, the annual return shall be filed within 60 days of the last date AGM ought to have been held along with a statement specifying the reason for not holding the AGM.
Extract of annual return	Every company shall place a copy of the annual return on the website of the company, if any, and the web-link of such annual return shall be disclosed in the Board's report.
Abridged form of annual return for OPC, small company etc.	Central Government may prescribe abridged form of annual return for "One Person Company, small company and such other class or classes of companies as may be prescribed.
Example	Big Fox Private Limited called its Annual General Meeting on 30th September, 2018 for laying down the financial statement for approval of its shareholders for the financial year

	ended 31st March 2018. However, due to want of quorum, the meeting could not take place and was cancelled. The company has not filed the annual financial statements, or the annual return for the year ending March 2018, with the RoC till date. The director is of the view that since the annual general meeting did not take place, the period of 60 days for filing of annual return is not applicable and thus, there is no contravention of section 92. Discuss. **Answer** The director is incorrect in holding that there no contravention of the provisions of the Companies Act, 2013. Section 92 states that every company has to file an annual return with the RoC in Form MGT – 7 within 60 days of date on which annual general meeting was held or the date when it must have been held. In the above case, the annual general meeting of Big Fox Private Limited should have been held by 30th September 2018, but it did not take place. Thus, the company has contravened the provisions of section 92 of the Companies Act, 2013 and shall be liable for a penalty as specified in Section 92(5) of the Act.
Penalties for Contravention	The company and its every officer who is in default shall be liable to a ➢ penalty of fifty thousand rupees and ➢ in case of continuing failure, with further penalty of one hundred rupees for each day during which such failure continues, subject to a maximum of five lakh rupees." If a company secretary in practice, certifies the annual return otherwise than in accordance with this section and the rules made thereunder, he shall be punishable with fine which shall not be less than INR 50,000 but which may extend to INR 5,00,000.

6. Place of Keeping & Inspection of Registers and Returns [Sec 94]

Place of Keeping

The registers and indices (as are required to be maintained u/s 88) and copies of annual return filed u/s 92) shall be kept either at

a) at the registered office; or

b) Any other place within the city, town or village in which the registered office is situated if

- such other place has been approved for this purpose by a special resolution passed in general meeting and
- more than 10% of the total number of members reside at such place.

Inspection

The registers, indices and copies of annual return shall be open for inspection by

i) any member or debenture holder or other security holder or beneficial owner without fees; and

ii) any other person on payment of prescribed fees [prescribed by Articles but maximum 50 for each inspection]

Inspection may be made

➢ on every working day

➢ during business hours at such reasonable time as the Board may decide subject to the condition that at least 2 hours on every working day shall be allowed for inspection.

Extracts of Registers and copies thereof

Any member, debenture-holder or security holder or beneficial owner can

- take the extracts during any business hour without payment of any fee or
- can also get copies thereof with payment of fee not exceeding INR 10 for each page.

Such copies or entries or return shall be supplied within 7 days of deposit of fee.

Penalty for refusing the inspection or making any extract or copy required –

If any inspection or the making of any extract or copy required under this section is refused, the company and every officer of the company who is in default, shall be liable for each such default, to a penalty of INR 1,000 for every day subject to a maximum of INR 1,00,000 during which the refusal or default continues.

The Central Government may also, by order, direct an immediate inspection of the document, or direct that the extract required shall forthwith be allowed to be taken by the person requiring it. [Section 94(5)]

Example

Mr. Himanshu is director of Road Less Travelled Limited and has been appointed as a nominee director of the company. On 6th December 2018, he expressed his interest to inspect register of members of the company. The company secretary refused to show him the register. In respect of the provisions of Companies Act, 2013, do you think that the company secretary was right in refusing Himanshu for not showing the register of members of the company?

Answer

As per section 94 (2), the registers and their indices, except when they are closed under the provisions of this Act, and the copies of all the returns shall be open for inspection by any member, debenture-holder, other security holder or beneficial owner, during business hours without payment of any fees and by any other person on payment of prescribed fees.

From the above provision it can be inferred that a director (not being member, debenture-holder, other security holder or beneficial owner) cannot make an inspection of the register of members without payment of fees. Thus, the company secretary was right in refusing to show the register of members to Himanshu.

However, Mr. Himanshu may do an inspection of register of members on payment of prescribed fees (the fees shall not exceed fifty rupees for each inspection.)

7. Preservation of Register of Members etc. and Annual Return [Rule 15]

Preservation of register of members:

Register of members along with the index shall be preserved permanently and shall be kept in the custody of company secretary of the company or any other person authorised by the Board for such purpose.

Preservation of register of debenture holders/ other security holders:

Register of debenture-holder or any other security holder along with the index shall be preserved for a period of 8 years from the date of redemption of debentures or securities, as the case may be, and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for such purpose.

Copies of documents filled with ROC to be preserved:

Copies of all annual returns prepared under section 92 and copies of all certificates and documents required to be annexed thereto shall be preserved for a period of 8 years from the date of filing with the RoC.

Preservation of foreign register:

It shall be preserved permanently, unless it is discontinued and all the entries are transferred to any other foreign register or to the principal register. Foreign register of debenture-holder or any other security holder shall be preserved for a period of 8 years from the date of redemption of debenture or securities.

8. Registers etc. to be Evidence [Sec 95]

The registers as required to be maintained u/s 88 and copies of Annual Return as required to be maintained u/s 92 shall be prima facie evidence of any matter directed or authorised by the Act to be inserted therein.

Note: Section 93 has been omitted.

ARISE AWAKE AND STOP NOT TILL YOUR GOAL IS ACHIEVED

-Swami Vivekanand

About CA Kishan Kumar

- ★ Kishan Kumar is an **Associate member** of The Institute of Chartered Accountants of India.
- ★ He is a **throughout Rankholder** in CA examinations.
- ★ He himself scored **Exemption in EIS-SM** in his CA Inter Exam..
- ★ He has been **awarded by Nitish Kumar, Hon'ble Chief Minister** of Bihar for his excellence in the field of education.
- ★ Internationally renowned **University of South Wales** has also felicitated him for his aptitude and achievements during his academic life.
- ★ Kishan has worked with **Ernst & Young and PwC (Big 4 Firms)** and uses his practical corporate experience to make the subject more interesting and engaging.
- ★ His students have secured **marks as high as 85** and hundreds have scored exemptions.
- ★ He is committed to make meaningful contribution to the life of promising CA aspirants.

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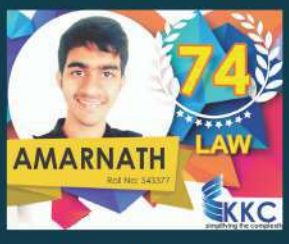

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CHAPTER 7B
MANAGEMENT & ADMINISTRATION - II
(GENERAL MEETING)

Every morning you have two choices: continue to sleep with your dreams, or wake up and chase them.

1. ESSENTIALS OF A VALID MEETING

In order to be valid, every meeting must be:

i) **Properly convened** i.e. must be called by proper authority and must be served in the proper manner, and

ii) **Properly constituted** i.e. proper quorum must be present at GM and proper chairman must preside it; and

iii) **Properly conducted** i.e. the business must be validity transacted at the meeting (i.e. resolutions must be properly moved and passed and voting must be proper.

2. PROPER AUTHORITY TO CALL A GENERAL MEETING

The meeting would be convened (called) by a proper authority. The proper authorities to call the meetings are:

1) Board of directors

- The proper authority to convene general meeting of a company is its Board of Directors.
- The Board of Directors should pass a resolution at Board Meeting to call a General Meeting.
- An individual director has no power to call a General Meeting.
- Notice of a meeting given by the secretary without the sanction of the Board of Directors is invalid. However, such notice may be ratified by the directors before the meeting.

2) Members

- Members of the company who fulfill the requirements of sec 100 also have a right to insist on the calling of an extraordinary meeting.
- As per the provisions of sec 100, members can themselves call the meeting in case of failure of the Board to call the EGM within specified time limit.

3) Tribunal

- Tribunal can call AGM u/s 97.
- Tribunal can call EGM u/s 98.

3. Notice of General Meetings [Sec 101]

A proper written notice to call the meeting should be given to every member of the company. The notice must be clear, explicit and unconditional.

A. Contents of notice

i) Place of meeting

In case of AGM	▪ Registered office of the Company; or ▪ Some other place within the same city, town or village in which the registered office of the company situated. ▪ However, AGM of an unlisted company may be held at any place in India if consent is given in writing or by electronic mode by all the members in advance.
Meeting other than by AGM	▪ Any place decided by the Board in India. ▪ An extraordinary general meeting of the company, other than of the wholly owned subsidiary of a company incorporated outside India, shall be held at a place within India.

ii) Day of the meeting

In case of AGM	▪ Any day that is not a national holiday.
Meeting other than by AGM	▪ On any day.

iii) Time of the meeting

In case of AGM	▪ During business hours of the company i.e. between 9 a.m. to 6 p.m. on any day. However, the Central Government may exempt any class of companies from this provision.
Meeting other than by AGM	▪ During any hours.

iv) Agenda

- The notice should contain a statement of business to be transacted at the meeting.
- As per section 102, if special business is to transacted, an **explanatory statement** should also be attached to the notice.
- The explanatory statement must state
  - a) the nature of concern or interest, financial or otherwise, if any, in respect of each items of—
    - i) every director and the manager, if any;
    - ii) every other key managerial personnel; and
    - iii) relatives of the persons mentioned in sub-clauses (i) and (ii);
  - b) any other information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon.
- It must also state the time and place where the documents in respect of such item can be inspected.

v) Rights to appoint proxy

The notice should also state that a member is entitled to appoint proxy who need not be member.

B. Service of notice

i) Manner

The notice must be served in the manner as prescribed in the Articles and the Companies Act, 2013.

ii) Notice to whom

a) Every member.

b) The legal representative of a deceased member.

c) The official assignee or receiver of an insolvent member.

d) The auditor of the company.

e) Every director of the company.

iii) Where should notice be sent

Their registered address in India.

If he has no registered address in India, to the address (within India) supplied by the member to the company for the purpose of giving notices to him.

iv) Mode of serving notice

The notice shall be given

i) in writing; or

ii) by electronic mode, in such manner as may be prescribed.

Notice by Electronic mode

A company may give notice through electronic mode. The notice may be sent

a) by e-mail as a text; or

b) as an attachment to e-mail; or

c) as a notification providing electronic link or uniform resource locator for accessing such notice.

The company shall provide an advance opportunity at least once in a financial year, to the members to register their e-mail addresses and to update their e-mail addresses.

The company's obligation shall be satisfied when it transmits the email. The company shall not be held responsible for a failure in transmission beyond its control.

If a member fails to provide or update relevant e-mail address to the company or to the depository participant, as the case may be, the company shall not be in default for not delivering notice via e-mail.

The notice of GM shall be simultaneously placed on-

a) the website of the company if any; and

b) such website as may be notified by CG.

v) Loss of notice in transit

A notice duly addressed and stamped and sent under the certificate of posting is deemed to have been duly served even if the notice does not reach the address.

vi) Accidental omission

An accidental omission to give notice or the non-receipt of notice by any member or any other person to whom it should be given shall not invalidate the proceedings of the meetings.

vii) Joint shareholding

In case of joint shareholdings, the notice shall be deemed to have been duly served if the same has been served on the joint holder named first in the register of members.

C. Length of Notice

i) Length of notice

For general meeting, at least 21 clear days' notice must be given to all the members.

However, in case of companies covered under section 8, which has not committed any default in filing its financial statements under section 137 or annual return under section 92 of the Act, with the Registrar; only 14 clear days' notice shall be given to all the members.

Example 1

The annual general meeting of Amreen Makeovers Private Limited is to be held on 5th April, 2017 at 3.00 p.m. What should be the appropriate time to send the notice by post, so that the provisions of section 101 are not contravened?

Answer

As per section 101 of the Companies Act, 2013 read with Rule 35(6) of the Companies (Incorporation) Rules, 2014, service shall be deemed to have been effected at the expiry of 48 hours after it is posted.

In case the general meeting is to be held at 3.00 p.m. on the 5th April, 2017, the service of notice shall be deemed to have been duly effected if it is despatched by post at any time before 3.00 p.m. on 13th March 2017. This will satisfy the requirement of 21 days clear notice as well as the 48 hours for transmission by post.

Example 2

Mr. Abeer filed a complaint against the company, Elixir Private Limited since it did not serve the notice to him for attending the annual general meeting. The company, in turn, provided the proof that they had sent the notice, by way of an email to Mr. Abeer, inviting him to attend the annual general meeting of the company. Abeer alleges that he never received the email. State whether the company is liable as guilty for contravening the provisions of section 101 of the Companies Act, 2013 read with Rules.

Answer

As per Rule 18(3) of the Companies (Management & Administration) Rules, 2014, the company's obligation shall be satisfied when it transmits the e-mail and the company shall not be held responsible for a failure in transmission beyond its control.

Also, if the member entitled to receive the notice fails to provide or update relevant e-mail address to the company, or to depository participant, as the case may be, company shall not be in default for not delivering notice via e-mail.

ii) Short notice

A shorter notice will be valid in the following cases:

Annual General meeting		95% members entitled to vote agree in writing or by electronic mode for a shorter notice.
Any other meeting	**Company having share capital**	Majority members who hold 95% of the paid-up share capital and are entitled to vote agree for a shorter notice.
	Company having no share capital	Members who hold 95% of the total voting power agree for a shorter notice.

iii) Consent for shorter notice

The consent to the shorter notice may be given either at the meeting or before the meeting.

iv) Calculation of 21 clear days

For calculating 21 clear days, the following should be excluded:

- the day of posting the notice;
- 48 hours of transmission;
- the day of meeting.

v) Newspaper notice

In case of members who have no registered address in India or those who have not supplied an address in India to the company for service of notice, newspaper notice of general meeting is given.

In case of newspaper advertisement of a notice, period of 21 clear days begins from the date on which the advertisement appears in the newspaper.

4. QUORUM FOR MEETING [SEC. 103]

A. Meaning of Quorum

Quorum may be defined as the minimum number of members

- who must be present at a meeting so that
- the business can be validly transacted at the meeting.

If the quorum is not present, the meeting shall not be valid and the proceedings of such meeting shall also be invalid.

B. Rules regarding quorum

i) Quorum for public company

Case	Number of members on date of meeting	Required quorum
1.	Up to 1000	5 members personally present
2.	More than 1000 but up to 5000	15 members personally present
3.	More than 5000	30 members personally present

ii) Quorum for private company

Two members personally present shall be quorum. Articles may provide for a larger number as the quorum.

C. Legal effect of non-availability of quorum

If within half an hour of starting the meeting, the quorum is not present then:

Meeting called at requisition of members u/s 100 (EGM)	- stands dissolved.
Other meetings	- Meeting shall be adjourned to such day, time and place as may be determined by the Board. - If the Board has not determined the day, time and place for meeting so adjourned, then the meeting shall be adjourned to same day in the next week at the same time and place.

Note: If at adjourned meeting also, a quorum is not present within half an hour from the time appointed for holding the meeting, the members personally present shall be quorum.

D. Presence of quorum

It is sufficient that the quorum is present at the beginning of the meeting. It need not be present throughout the meeting or when the when the meeting proceeds to vote on any resolution.

Example 1

There are 54 members of Dicey Private Limited. The company held its annual general meeting on 1st July 2017 at 2.00 p.m. and 28 members were present till 2.45 p.m. The Chairman of the meeting proceeded to initiate the meeting and passed the resolutions as discussed in the meeting. Comment whether the meeting took place as per the provisions of Companies Act, 2013.

Answer

As per the provisions of Section 103 of the Companies Act, 2013, the quorum for a Private Limited Company shall be two members personally present. Thus, the quorum for the annual general meeting of Dicey Private Limited was complied with and the company is not in contravention with any of the provisions of the Companies Act, 2013.

Example 2

Abbey Limited has 2300 members and the annual general meeting of the company is due to be held on 23rd February 2017 at 10.30 a.m. On the day of the meeting, 18 members were personally present by 11.00 a.m. and the Chairman proceeded to initiate the chronicles of the meeting. There were 5 special businesses to be discussed at the said meeting and by 2.30 p.m. Agenda 1 to 3 had been discussed and appropriate resolutions were passed. However, due to some emergency, 4 of the members had to leave around 3 p.m. The Chairman granted them the permission and proceeded to discuss Agenda 4 & 5 and accordingly passed resolution as per the consent of the remaining members.

Comment whether the meeting is a properly convened meeting as per the provisions of section 103 of the Companies Act, 2013.

Answer

In the above case, while the appropriate quorum was present at the time when the meeting started as per section 103 of the Companies Act, 2013, the quorum was not present at the time of deciding Agenda 4 & 5. It has been held that where at the time of transacting business, the number of members is less than the quorum fixed for the meeting, the business cannot be transacted and shall be a nullity.

4.1. General Provision of Quorum For Meeting

Proxy	▪ Proxies are not counted for quorum. Even articles cannot provide for counting of proxies for the purpose of quorum.
Preference shareholders	▪ Preference shareholders present in the meeting are not counted for quorum except where the business to be transacted at the meeting directly affects them.
Joint holders	▪ They are counted as one member for the purpose of quorum.
Member present in two capacities	▪ A member who is present in two capacities i.e. as an individual as well as a trustee, he may be counted as two members.
Company	▪ If a company is a member of another company, the person appointed by the Company to act as representative of the company at the meeting shall be counted for quorum. ▪ Where two or more companies, being member of another company, appoint single person as their representative, then each such company will be counted separately.
President/Governor	▪ Where the President of India or the Governor of a State holds shares in a company and appoints a person to act as his representative at the meeting, such representative shall be counted for quorum.

Members below quorum - Where the total number of members of a company is reduced below the quorum fixed by the articles, the quorum shall be deemed to be achieved by the company if all members of the company personally attend the meeting.

5. Chairman of the Meeting [Sec. 104]

A chairman is necessary for conducting a meeting. He presides over the meeting and his main function is to keep order and see that the business is properly conducted.

The chairman is the proper person to put resolution to the meeting, count the votes, declare the results and authenticate the minutes BY SIGNATURE.

i) Appointment of the chairman

Appointment of the chairman is usually regulated by the Articles of the company.

ii) In case chairman is not present

If there is nothing in the Articles or if the designated chairman is absent, the members personally present at the meeting shall elect one of them to be the chairman of the meeting on a show of hands.

iii) If subsequently the designated chairman arrives

The elected chairman shall vacate the chair.

iv) If a poll is demanded on the election of the chairman

The chairman elected on a show of hands shall exercise all the powers of the chairman till the poll is taken. If some other person is elected chairman as a result of the poll, he shall be the chairman for the rest of the meeting.

5.1. Powers of Chairman

i) To maintain order and decorum of the meeting

The chairman has the power to prevent use of improper language and disorderly behavior of members.

If his directions are not obeyed, he may adjourn the meeting or expel the offending members from the meeting.

ii) To decide priority of speakers

When more than one member expresses their desire to speak on the motion, the chairman has the power to decide the priority in which the members will be allowed to speak.

iii) To adjourn the meeting

The chairman can adjourn the meeting under certain circumstances.

However, if the majority of the members vote against adjournment, the chairman shall not be empowered to adjourn the meeting except

a) When so authorized by the articles; or

b) When the quorum for meeting is absent.

iv) To exercise casting vote

- The chairman has a casting vote if so provided by the articles of association.
- The casting vote can be used only for passing an ordinary resolution and not for special resolution.
- Casting vote can be used before declaration of result of voting and not afterwards.

6. Proxy [Sec 105]

Meaning	▪ Proxy is a representative of a member appointed by him to attend and vote at the meeting on his behalf. ▪ Any person may be appointed as the proxy. It is not necessary that a proxy must be a member of the company. ▪ In case of company registered under section 8, only a member can be a proxy holder in a of the Companies Act, 2013.
Restriction	i) Unless the Articles of the company provide otherwise, a member of a company having no share capital is not entitled to appoint proxy. ii) A proxy shall not be entitled to vote except on poll.
Mode	▪ The appointment of a proxy must be made by a written instrument and it should be signed by the member or his duly authorized attorney.
Notice of meeting	▪ The notice of meeting must clearly state that a member is entitled to appoint proxy and also that the proxy may not be a member.
Time limit	▪ The instrument of proxy must be deposited with the company 48 hours before the meeting.
Inspection of proxy forms	▪ Proxy forms can be inspected during the period beginning 24 hours before the commencement of meeting and ending with the conclusion of the meeting by a member entitled to vote at a meeting of the company or any resolution to be moved at the meeting.
Right of proxy	▪ The proxy has no right to speak at the meeting. However, he can demand poll.
Disabilities of proxy	▪ Proxy cannot vote by show of hands. ▪ Proxy is not counted for the purpose of quorum.
Adjourned meeting	▪ The proxy shall also be valid for adjourned meeting. ▪ A member who has attended the original meeting may also appoint proxy for the adjournment meeting.
Revocation	▪ The proxy is revocable. However, it can be revoked only before voting. i) Where the member appointing the proxy personally attends and votes at the meeting, the proxy shall stand revoked. ii) Death of member. Article may provide otherwise.
Death of member	▪ Unless the articles provide otherwise, death of a member appointing proxy results in revocation of the proxy. ▪ But if the company has no notice of death, vote given by the proxy will be valid.

7. REPRESENTATIVES [SEC 112 AND 113]

A. Representative of the President and Governor in Meetings of Companies [Sec 112]

If the President or Governor of the State is a member in any company, he may authorize such person (as it thinks fit) as his representative at any General Meeting or class meeting of such company.

A person appointed as representative is entitled to exercise the same rights and powers (including the right to vote by proxy/ postal ballot) as if he is a member of a company.

B. Representative of Corporation at the meeting of companies and Creditors [Sec 113]

Section 113 of the Companies Act, 2013 seeks to provide that where a body corporate is member or creditor of the company, they may authorize a person to act as its representative in the meeting of the company. The provision is as under-

Appointment of representative by a body corporate: A body corporate, whether a company within the meaning of this Act or not, may:

a) **if it is a member of company -** by resolution of its Board of Directors or other governing body, authorise such person as it thinks fit to act as its representative at any meeting of the company, or at any meeting of any class of members of the company;

b) **if it is a creditor, including a holder of debentures, of a company-,** by resolution of its directors or other governing body, authorise such person as it thinks fit to act as its representative at any meeting of any creditors of the company held in pursuance of this Act or of any rules made thereunder, or in pursuance of the provisions contained in any debenture or trust deed, as the case may be.

Powers and rights of an authorised representative

A person appointed as representative is entitled to exercise the same rights and powers (including the right to vote by show of hands/ postal ballot) as if he is a member of a company.

8. Voting at the Meetings [Sec 106 - 110]

The meeting takes places with an agenda or say, the decisions to be taken by the company's members which are crucial for the working of the company. So, the meeting takes place to discuss and decide upon the topics which are important – thus this decision requires consensus of the members attending the meeting.

This consensus is reached through voting. As per the Companies Act, 2013, the voting in a meeting can take place in the following ways–

- Voting by show of hands – (section 107);
- Voting by electronic means – (section 108);
- Voting by demand of poll – (section 109);
- Voting by Postal Ballot – (section 110).
- Restriction on Voting Rights - (section 106).

8.1. Voting by Show of Hands [Sec 107]

- At a general meeting, a resolution shall be decided on a show of hands unless a poll is demanded u/s 109 of Companies Act, 2013.
- After counting the number of hands for and against the resolution, the chairman declares the result.
- On a voting by show of hands, one member has one vote and a proxy cannot vote.
- A declaration of the result of voting by show of hands by the chairman and the entry in the minute books shall be conclusive evidence of such fact. No proof as regards to number of votes against or favor is required.

Question: Can an insolvent shareholder vote at the meeting by show of hands?

Yes. Notwithstanding that he has no longer any beneficial interest in the shares and the dividends are payable only to his trustee in bankruptcy, an insolvent shareholder so long as he remains in the register of the company as a member, is entitled to exercise his votes which are attributed to his status as member.

8.2. Voting by Poll [Sec 109]

- Under this method, the voting right of a member is according to the number of shares held by him.
- A poll may be ordered by the chairman either on its own or on demand made my members.

- A proxy can also demand poll and vote by poll.
- **Scrutinizers at poll**

a) Where a poll is to be taken, the Chairman shall appoint such number of scrutineers as may deem fit.

b) The scrutineers shall scrutinize the poll process and votes given on poll.

c) The scrutineers shall report to the Chairman in such manner as may be prescribed.

d) The Scrutinizers' report shall state total votes cast, valid votes, votes in favour and against the resolution including the details of invalid polling papers and votes comprised therein.

e) The Scrutinizers shall submit the Report to the Chairman who shall counter-sign the same.

f) The Chairman shall declare the result of Voting on poll. The result may either be announced by him or a person authorized by him in writing.

8.2.1. Rules regarding Demand for Poll

A. Demand for poll suo - moto by the chairman

On or before declaration of the result of voting on a resolution by show of hands, a poll may be ordered by the chairman of the Meeting on his own motion or on demand made by the members.

B. Demand of Poll by members

Public company	Poll may be demanded by any member or members, present in person or proxy, and holding shares in the company: ➢ Carrying not less than 1/10th of the total voting power; or ➢ on which aggregate of not less than INR 5,00,000/- has been paid up.
Any other company	By any member or members, present in person or proxy, and having not less than 1/10 of the total voting power.

C. Time limit for taking poll

i) Poll relating to adjournment of meeting or election of chairman - Must be taken immediately.

ii) Poll relating to other matters – Must be taken within 48 hours of demand for poll.

D. Use of votes differently

On a poll being taken, a member or a proxy need not

- Use all of his votes or
- Cast all the votes he uses in the same way.

Applicability of section 101 to 107 and 109 to Private companies-

Section 101 to 107 and 109 shall apply unless otherwise specified in respective sections or the articles of the company provide otherwise.

This exception shall be applicable to a private company which has not committed a default in filing its financial statements u/s 137 or annual return u/s 92 of the Act, with the Registrar.

8.3. Voting through Electronic Means [Sec 108]

This is a new mode of voting in meetings which has been introduced in the Companies Act, 2013 and provides that a member in the prescribed class of companies may exercise his right to vote by electronic means.

Companies providing its members to exercise right to vote by electronic means:

Every company which has

- listed its equity shares on a recognised stock exchange and
- every company having not less than one thousand members shall

- provide to its members facility to exercise their right to vote on resolutions proposed to be considered at a general meeting by electronic means:

Procedure:

A company which provides the facility to its members to exercise voting by electronic means shall comply with the following procedure, namely:

i) Notice of meeting: The notice of the meeting shall be sent to all the members, directors and auditors of the company either-

a) by registered post or speed post; or
b) through electronic means, namely, registered e-mail ID of the recipient; or
c) by courier service;

ii) Notice to be hosted on website: the notice shall also be placed on the website, if any, of the company and of the agency forthwith after it is sent to the members;

iii) Notice containing the particular: the notice of the meeting shall clearly state -

a) that the company is providing facility for voting by electronic means and the business may be transacted through such voting;

b) that the facility for voting, either through electronic voting system or ballot or polling paper shall also be made available at the meeting and members attending the meeting who have not already cast their vote by remote e-voting shall be able to exercise their right at the meeting;

c) that the members who have cast their vote by remote c-voting prior to the meeting may also attend the meeting but shall not been titled to cast their vote again;

iv) The notice shall:

a) indicate the process and manner for voting by electronic means;
b) indicate the time schedule including the time period during which the votes may be cast by remote e-voting;
c) provide the details about the login ID;
d) specify the process and manner for generating or receiving the password and for casting of vote in a secure manner.

v) Publication of notice: The company shall cause a public notice by way of an

- advertisement to be published, immediately on completion of dispatch of notices for the meeting but
- at least twenty- one days before the date of general meeting,
- at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and having a wide circulation in that district, and
- at least once in English language in an English newspaper having country-wide circulation, and
- specifying in the said advertisement, inter alia, the following matters, namely:

a) statement that the business may be transacted through voting by electronic means;
b) the date and time of commencement of remote e-voting;
c) the date and time of end of remote e-voting;
d) cut-off date;
e) the manner in which persons who have acquired shares and become members of the company after the dispatch of

notice may obtain the login JD and password;

f) the statement that-

(A) remote e-voting shall not be allowed beyond the said date and time;

(B) a member may participate in the general meeting even after exercising his right to vote through remote e-voting but shall not be allowed to vote again in the meeting; and

(C) a person whose name is recorded in the register of members or in the register of beneficial owners maintained by the depositories as on the cut-off date only shall be entitled to avail the facility of remote e-voting as well as voting in the general meeting;

g) website address of the company, if any, and of the agency where notice of the meeting is displayed; and

h) name, designation, address, email id and phone number of the person responsible to address the grievances connected with facility for voting by electronic means:

Provided that the public notice shall be placed on the website of the company, if any, and of the agency;

vi) Time for opening of e-voting: the facility for remote e-voting shall remain open for not less than three days and shall close at 5.00 p.m. on the date preceding the date of the general meeting;

vii) Option for remote e-voting: During the period when facility for remote e- voting is provided, the members of the company, holding shares either in physical form or in dematerialized form, as on the cut-off date, may opt for remote e-voting:

Provided that once the vote on a resolution is cast by the member, he shall not be allowed to change it subsequently or cast the vote again:

viii) At the end of the remote e-voting period, the facility shall forthwith be blocked:

Provided that if a company opts to provide the same electronic voting system as used during remote e-voting during the general meeting, the said facility shall be in operation till all the resolutions are considered and voted upon in the meeting and may be used for voting only by the members attending the meeting and who have not exercised their right to vote through remote e voting.

ix) Appointment of scrutinizer: The Board of Directors shall appoint one or more scrutinizer, who may be Chartered Accountant in practice, Cost Accountant in practice, or Company Secretary in practice or an Advocate, or any other person who is not in employment of the company and is a person of repute who, in the opinion of the Board can scrutinize the voting and remote e-voting process in a fair and transparent manner:

Provided that the scrutinizer so appointed may take assistance of a person who is not in employment of the company and who is well-versed with the electronic voting system;

x) Function of scrutinizer: the scrutinizer shall be willing to be appointed and be available for the purpose of ascertaining the requisite majority;

xi) Role of Chairman: The Chairman shall, at the general meeting, at the end of discussion on the resolutions on which voting is to be held, allow voting, with the assistance of scrutinizer, by use of ballot or polling paper or by using an electronic voting system for all those members who are present at the general meeting but have not cast their votes by availing the remote e-voting facility.

xii) Counting of votes: The scrutinizer shall, immediately after the conclusion of voting at the general meeting, first count the votes cast at the meeting, thereafter unblock the votes cast through remote e-voting in the presence of at least two witnesses not in the employment of the company and make, not later than three days of conclusion of the meeting, a consolidated scrutinizer's report of the total votes cast in favour or against, if any, to the Chairman or a person authorized by him in writing who shall countersign the same:

Provided that the Chairman or a person authorized by him in writing shall declare the result of the voting forthwith;

Explanation: It is hereby clarified that the manner in which members have cast their votes, that is, affirming or negating the resolution, shall remain secret and not available to the Chairman, Scrutiniser or any other person till the votes are cast in the meeting.

xiii) **Access to details:** For the purpose of ensuring that members who have cast their votes through remote e-voting do not vote again at the general meeting, the scrutiniser shall have access, after the closure of period for remote e-voting and before the start of general meeting, to details relating to members, such as their names, folios, number of shares held and such other information that the scrutiniser may require, who have cast votes through remote e-voting but not the manner in which they have cast their votes:

xiv) **Maintenance of Register:** The scrutiniser shall maintain a register either manually or electronically to record the assent or dissent received, mentioning the particulars of name, address, folio number or client ID of the members, number of shares held by them, nominal value of such shares and whether the shares have differential voting rights;

xv) **Safe Custody of register:** The register and all other papers relating to voting by electronic means shall remain in the safe custody of the scrutiniser until the Chairman considers, approves and signs the minutes and thereafter, the scrutiniser shall hand over the register and other related papers to the company.

xvi) **Result on websites:** The results declared along with the report of the scrutiniser shall be placed on the website of the company, if any, and on the website of the agency immediately after the result is declared by the Chairman:

Provided that in case of companies whose equity shares are listed on a recognised stock exchange, the company shall, simultaneously, forward the results to the concerned stock exchange or exchanges where its equity shares are listed and such stock exchange or exchanges shall place the results on its or their website.

xvii) **Passing of date of resolution:** Subject to receipt of requisite number of votes, the resolution shall be deemed to be passed on the date of the relevant general meeting.

xviii) **Resolution not to be withdrawn:** a resolution proposed to be considered through voting by electronic means shall not be withdrawn.

8.4. VOTING BY POSTAL BALLOT [SEC 110]

The members may cast their votes through postal ballot in certain cases and subject to certain conditions.

A. Power

A listed public company may get any resolution passed by means of postal ballot.

However, in case of resolution relating to such business as the Central Government may, by notification, declare to be conducted only by postal ballot, the company shall pass the resolution by postal ballot only.

B. Notice

The company shall send a notice to all shareholders along with a draft resolution

- explaining the reasons therefore; and
- requesting them to send their vote
- on a postal ballot
- within a period of 30 days from the date of posting of the letter.

Note: The assent or dissent received after thirty days from the date of issue of notice shall be treated as if reply from the member has not been received.

C. Mode of sending notice

The notice shall be sent either

i) By registered post acknowledgment due; or

ii) Under certificate of posting; or

iii) Courier service.

Note: Such notice shall also be displayed on website.

D. Newspaper advertisement

An advertisement should also be published about dispatch of ballot papers in

i) a leading English newspaper; and

ii) one vernacular newspaper,

circulating in the district in which the registered office of the company is situated containing, inter alia, following

a) a statement to the effect that the business is to be transacted by postal ballot which includes voting by electronic means;

b) the date of completion of dispatch of notices;

c) the date of commencement of voting;

d) the date of end of voting;

e) the statement that any postal ballot received from the member beyond the said date will not be valid and voting whether by post or by electronic means shall not be allowed beyond the said date;

f) a statement to the effect that members, who have not received postal ballot forms may apply to the company and obtain a duplicate thereof; and

g) contact details of the person responsible to address the grievances connected with the voting by postal ballot including voting by electronic means.

at least 5 days before beginning of voting period.

E. Prepaid envelope

The notice shall include a postage prepaid envelope to facilities the shareholders in communication of their vote on the resolution within the time limit.

F. Passing of resolution

If a resolution is assented to by requisite majority of shareholders, the resolution shall be deemed to have been passed.

G. Fraud

If a shareholder sends his vote through postal ballot and thereafter any person

- fraudulently defaces or destroys the ballot paper or declaration of the identity of the shareholder,

such a person shall be punishable with fine or with imprisonment up to 6 months or both.

H. Default

If a default is made in compliance of any of the above provisions, the company and every officer in default shall be punishable with fine up to INR 50,000 in respect of each default made.

I. List of business where resolution through postal ballot shall be passed

i) Alteration in the object clause of memorandum.

ii) Variation in the rights attached to a class of shares or debentures or other securities.

iii) Buy back of shares of the company.

iv) Alteration of Articles of Association for inserting provisions relating to private company.

v) Election of small shareholder's directors.

vi) Change in place of registered office of a company outside the local limits of any city, town or village.

vii) Giving loans, extending guarantee or providing security in excess of the limit prescribed.

viii) Sale of the whole or substantially whole of the undertaking of a company.

ix) Issue of shares with differential voting rights.

However, any item of business required to be transacted by means of postal ballot may be transacted at a general meeting by a company which is required to provide the facility to members to ***vote by electronic means under section 108***, in the manner provided in that section.

J. Postal ballot Not Allowed for certain business

Postal ballot cannot be used for transacting following businesses:

a) Ordinary business

b) Any business in respect of which directors or auditors have a right to be heard at the meeting.

K. Miscellaneous Points

1) Appointment of scrutinizer

The Board of Directors shall appoint one scrutinizer, who is not in employment of the company and who, in the opinion of the Board, can conduct the postal ballot voting process in a fair and transparent manner.

2) Register to be maintained by the scrutinizer

The scrutinizer shall maintain a register either manually or electronically. The register shall contain details with respect to voting by shareholders by postal ballot

i) his assent or dissent received

ii) his name, address or client ID

iii) number of shares held by him, nominal value of such shares and whether shares have differential voting rights

iv) details of postal ballots which are received in defaced or mutilated form;

v) details of postal ballot forms which are invalid.

3) Report of the scrutinizer

The scrutinizer shall submit his report as soon as possible after the last date of receipt of postal ballots but not later than 7 days thereof.

The assent or dissent received after 30 days from the Date of issue of notice shall be treated as if reply from the member has not been received.

4) Prohibition on destroying postal ballot

No person shall deface or destroy the postal ballot papers received back from the shareholders.

No person shall declare the identity of any shareholder who has recorded his assent or dissent on the postal ballot.

5) Display of result on the website

The company shall place on its website

a) Result of postal ballot; and

b) Scrutinizer' s report.

6) How does the counting happen at the time of postal ballot?

It is important to know here that, a member who is voting by way of postal ballot, has votes in proportion to his share

in the paid-up share capital of the company. And in this regard, he need not use all his votes not does he need to use all his votes in the same way. Therefore, 4 types of ballots may be received from the shareholders:

a) Ballots which contain assents;

b) Ballots which contain dissents;

c) Ballots wherein the member has voted partially assenting, partially dissenting or using not all his shares in any particular way; and

d) Invalid ballots (due to absence/ mismatch of signature, overwriting, etc)

9. Restrictions on Voting Rights of Members [Sec. 106]

A company shall not prohibit any member from exercising his voting rights on any other ground except the grounds mentioned in the Article.

- **Manner of imposing restrictions**

Express provisions in the Articles are required to restrict the voting rights of members.

- **Grounds of imposing restrictions**

Only 2 valid grounds

i) Calls on shares or any other sum presently payable by the member has not been paid.

ii) The company has exercised a right of lien on shares.

Note: Such member whose voting rights has been legally restricted can't sign a requisition for an EGM.

Note: Where the articles of the company do not contain any provision restricting the exercise of voting right of member, a member cannot be prevented from voting, even though, calls or other sum payable by him have not been paid or the company has exercised any right of lien over his shares.

But, where the articles contain any such provision, and the shares forfeited for non-payment of calls have been re-allotted, the new allottee being liable for the balance remained unpaid on the shares will not be entitled to vote so long as any calls presently payable on the shares remain unpaid.

Example 1

Where the articles of the company do not contain any provision restricting the exercise of voting right of member, a member cannot be prevented from voting, even though, calls or other sum payable by him have not been paid or the company has exercised any right of lien over his shares.

But, where the articles contain any such provision, and the shares forfeited for non-payment of calls have been re-allotted, the new allottee being liable for the balance remained unpaid on the shares will not be entitled to vote so long as any calls presently payable on the shares remain unpaid.

Example 2

What happens in case of voting by joint shareholders? Suppose that Mr. & Mrs. Iyer are joint shareholders of Goal Private Limited and they hold 500 shares of the company. Regarding a particular special business being transacted at the extra-ordinary general meeting of the company, Mr. Iyer is in the favour of the decision, whereas Mrs. Iyer is against the resolution. Decide how should the vote be casted in case of this situation?

Answer

Joint shareholders must agree in voting unless the articles provide to the contrary. The voting in case of joint shareholders is done in the order of seniority, which is determined on the basis of the order in which their names appear in the register of members/ shareholders. The joint-holders have a right to instruct the company as to the order in which their names are to appear in the register.

Example 3

Consider a situation where directors are also the shareholders of the company.

Directors, who are also the shareholders of the company, stand in a fiduciary relationship with the company in their capacity as directors. However, a director should vote as a common shareholder would vote in a general meeting, and need not be influenced by the fact of his being a director.

10. RESOLUTIONS [SEC. 114 - 117]

A resolution is the formal decision of an organization while transacting a business at a meeting. A motion which has obtained the necessary majority vote in favour becomes a resolution. So, in effect there is a difference between Motion and Resolution.

Difference between Motion & Resolution

i) Most matters come before a meeting by way of a motion recommending that the meeting may express approval or disapproval or take certain action or order something to be done.

ii) A motion is a proposal, and a resolution is the adoption of a motion duly made and seconded. But every motion need not be followed by a resolution, as where a motion is made for the adjournment of the meeting.

As per the Companies Act, 2013, resolutions are of two types–

a) Ordinary Resolutions – which are passed by simple majority; and

b) Special Resolutions – which are passed by 75% majority.

10.1. ORDINARY AND SPECIAL RESOLUTIONS [SEC. 114]

Resolutions may be defined as the proposal which is voted at a General Meeting and accepted by the members. The business of a meeting is conducted in the form of resolutions.

A. Ordinary Resolution

1) Meaning

When a resolution is passed by the simple majority of the members voting at a general meeting, it is said to have been passed by ordinary resolutions. Thus, an ordinary resolution is one where

- votes cast in favor of the motion are more than the votes cast against the motion.

2) Condition for passing the ordinary resolution

The notice of general meeting must have been duly given.

B. Special Resolutions

1) Meaning

A special resolution is one in which votes in favour should not be less than 3 times the votes against the resolution.

2) Conditions for passing the special resolutions

a) Intention to propose special resolution must be specified in the notice

It is required that the intention to propose the resolution as special resolution should have been specified in the notice calling the General Meeting.

b) The notice of general meeting must have been duly given.

c) **Filing of special resolution -** A copy of every special resolution (together with explanatory statement) has to be filed with the register within 30 days of passing such resolution.

3) Votes may be cast by way of

a) Show by hands; or

b) By poll; or

c) Electronically; or

d) By postal ballot.

Note: Votes cast shall include the casting vote of the chairman, if any.

10.1.1. Cases where Ordinary Resolution is Passed

Following are some of the cases where ordinary resolution is passed:

i) Rectification of Name on direction of Central Government

ii) Issue of shares with differential rights

iii) Issue of Bonus shares

iv) Alteration of capital clause

v) Conversion of shares into stock and vice versa

vi) Acceptance of deposit from members

vii) Acceptance of deposit from Public by Eligible Companies (in case deposit is within limits u/s 180 (1)(c))

viii) Consider and adopt Annual Accounts, Auditor's Report and Board's Report

ix) Declaration of dividends

x) Appointment and re-appointment of auditors

xi) Appointment and re-appointment of Directors.

10.1.2. Cases where Special Resolution is Passed

Following are the few cases where special resolution is passed:

i) To alter object clause of memorandum.

ii) To alter the name of the company (voluntarily).

iii) To change the registered office of the company outside the local limits of village, town or city.

iv) To commence a new business.

v) To alter the articles of association.

vi) To raise funds through private placement.

vii) To vary rights of any class of shareholder.

viii) Issue of preference shares

ix) Issue of sweat Equity Shares

x) To reduce the share capital of the company.

xi) To create reserve capital.

xii) To buy back its own shares above the prescribed limit.

xiii) To issue further shares to outsiders without right issue.

xiv) Acceptance of deposit from Public by Eligible Companies (in case deposit exceeds limits u/s 180 (1)(c))

xv) Keeping Registers and returns at place other than Registered Office.

xvi) Removal of auditor before expiry of his term.

10.2. Resolution Requiring Special Notice [Sec 115]

A. When is special Notice required?

Any provision contained in the Act or in the Articles of a company may provide that special notice shall be required to move a resolution at a GM.

B. Legal requirement for special notice

If special notice is required to move a resolution at a GM, then the notice of the intention to move such a resolution shall be given to the Company

- not earlier than 3 months before the date of GM but
- at least 14 days before the GM (excluding the day on which such notice is given and the date of GM).

Note: Such notice of intention should be signed by the member(s) holding

i) not less than 1% of voting power; or

ii) member(s) holding paid up share capital of not less than INR 5,00,000/-.

C. Notice to be given to the members

On receipt of special notice, the company shall give notice of the intention to move the resolution to all its members in the manner prescribed under Rule 23 of the Companies (Management and Administration) Rules, 2014:

i) The company shall give notice of the intention to move the resolution to all its members at least 7 days before the date of GM (excluding the day on which such notice is given and the day of GM).

ii) The notice shall be given in the same manner in which the company gives notices of GM.

iii) If it is not practicable to give the notice in the same manner as it gives notice of any GM then

a) The notice shall be published:

- at least 7 days before the date of GM (excluding the day of publication of notice and the date of GM);
- in English language in an English newspaper; and
- in vernacular language in a vernacular newspaper
- both having wide circulation in the state where the registered office of the company is situated.

b) Such notice shall also be place on the website, if any, of the company.

D. Resolutions requiring special notice as per the Act

i) A resolution for appointing a person other than retiring auditor as an auditor at the AGM.

ii) A resolution for expressly providing that the retiring auditor shall not be reappointed at the AGM.

iii) A resolution for removing a director before the expiry of his term of office.

iv) A resolution for appointing a director (in place of a director removed before the expiry of his period of office) at the meeting at which the director is removed.

10.3. Effect of Resolutions Passed at the Adjourned Meetings [Sec. 116]

A resolution passed at an adjourned meeting shall be treated as passed on the same date on which it was actually passed and not on any earlier date.

Example

The extra-ordinary general meeting of the company, Purple Banana Private Limited was due to be held on 23rd September 2018. However, due to want of quorum, the meeting was adjourned to a later date on 1st October 2018 and two resolutions were passed on that date.

Now, as per section 116 of the Companies Act, 2013, the said two resolutions shall be deemed to have been passed on the original date of meeting, i.e. 1st October 2018 and not on the earlier date.

10.4. Resolutions and Agreements to be Filed [Sec 117]

Mandatory filing of resolution and agreements	The company shall file with ROC a copy of a) every resolution (together with explanatory statement, if any); and b) every agreement which is required to be filed as per sec. 117(3) in the manner prescribed by CG along with the prescribed fee.
Time limit	Within 30 days of a) Passing of such resolution b) Making of such agreement.
Resolution and agreement required to be filed as per sec. 117(3)	a) Special Resolution. b) Any resolution of the Board of Directors of a company or agreement executed by a company, relating to the appointment, re-appointment or renewal of the appointment or variation of the terms of appointment of a Managing Director. c) Resolution requiring a company to be wound up voluntary in pursuance of sec. 59 of the Insolvency and Bankruptcy Code, 2016. d) Resolutions passed by the members in GM authorizing the Board of Directors to sell, lease or otherwise dispose off whole or substantially the whole of the undertaking of the company. e) Any other resolution or agreement as may be prescribed and placed in the public domain.
Penalty	In case of failure to intimate RoC about the resolutions and agreements that are required to be filed within the time specified therein i) **such company** shall be liable to a penalty of ➢ one lakh rupees and ➢ in case of continuing failure, with further penalty of five hundred rupees for each day after the first during which such failure continues, ➢ subject to a maximum of twenty-five lakh rupees and ii) **every officer in default including liquidator of the company,** if any, shall be liable to a penalty of ➢ fifty thousand rupees and ➢ in case of continuing failure, with further penalty of five hundred rupees for each

	day after the first during which such failure continues, ➢ subject to a maximum of five lakh rupees.
Non-Applicability to Pvt. Company	Section 117 shall not apply to Private companies which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with RoC.

11. Difference between Ordinary Business, Special Business and Ordinary Resolution & Special Resolution and Resolutions requiring Special Notice

To be discussed in Class with Examples!!

After studying the above concepts, it is quite common to get confused between the terms. Generally, the people think that a "special business" can only be transacted by means of a "special resolution", which is a misapprehension. A special resolution is required for transacting business only where it is specifically so required by the Act. All other business can be transacted by an ordinary resolution.

Example

In the annual general meeting of Black Mango Limited, the notice contained the agenda for 8 special businesses to be transacted. The Chairman decided to move all the resolutions at one time in order to save time of the members present at the meeting. Discuss whether two or more resolutions can be moved together as per the provisions of the Companies Act, 2013.

For the sake of avoiding confusion and mixing up, the resolutions are moved separately. However, there is nothing illegal if the Chairman of the meeting desires that two or more resolutions should be moved together, unless any member requires that each resolution should be put to vote separately or unless a poll is demanded in respect of any.

The only case where a resolution should be moved separately is the one which requires that as regards the appointment of directors at a general meeting of a public or private company, where two or more directors may not be appointed as directors by a single resolution.

Where notice has been given of several resolutions, each resolution must, be put separately. However, if the meeting unanimously adopts all the resolutions, this would not be material.

12. Circulation of Member's Resolution and Statement [Sec 111]

A. Need

Members can use administrative machinery of a company

i) to propose a resolution at the company's subsequent AGM; or

ii) to circulate to members any statement with respect to the matter referred to in any proposed resolution or any business to be dealt with at any GM.

B. Requisition

The members may serve a requisition **in writing** on the company requiring the company to give notice of resolution to the members or to circulate the explanation to the members.

C. Signed

The requisition must be signed by

Company having share capital	Members holding at least 1/10th paid up share capital.
Company NOT having share capital	Members holding at least 1/10th of the total voting power.

D. Time limit for deposit

i) Where requisition proposes a resolution

The requisition shall be valid only if it is deposited 6 weeks before the AGM.

However, if after the requisition is deposited with the Company, an AGM is called on a date within 6 weeks of the date of deposit of the requisition, the requisition shall be deemed to be properly deposited.

ii) Where requisition requires circulation of a statement

The requisition shall be valid only if it is deposited at least 2 weeks before the date of GM.

E. On receiving the Requisition from the members, the company shall be bound to

i) Give a notice to the members, of the resolution intended to be moved at the next AGM at least six weeks before AGM.

ii) Circulate the statement among the members entitled to notice of any General Meeting at least two weeks before GM.

F. Check on abuse of Sec. 111

A company is authorized not to circulate a resolution or statement of the requisition if Central Government[1], on the application of the company or any aggrieved party, is satisfied that the right so conferred is being abused to

- secure needless publicity for defamatory matters.

An order may also direct that the cost incurred by the company in making the application to CG shall be paid to the company by the requisitionists, notwithstanding that they are not parties to the application.

Effect of default

If any default is made in complying with the provisions of this section, the company and every officer of the company who is in default shall be liable to a penalty of INR 25,000/-.

13. MINUTES [SEC 118]

The minutes may be defined as the written record of the business transacted at a meeting.

A. Purpose/Contents

Every company is under statuary obligation to keep fair and correct record of all the proceedings of every

- General meeting;
- Board meeting;
- Meeting of the committee of the Board

in a **distinct minute book.**

All the appointments made at the **General Meeting** must be included in the proceeding.

In the case of a **Board Meeting** or a meeting of a committee of the Board, the minutes shall also contain–

- The names of the directors present at the meeting; and
- In the case of each resolution passed at the meeting, the names of the directors, if any, dissenting from, or not concurring with the resolution.

Note: Minutes kept as per sec. 118 shall be **evidence of the proceedings** recorded therein.

B. Chairman's Discretion

The chairman has absolute discretion in not recording a statement which he thinks is

[1] *Power delegated to Regional Director*

- Defamatory of any person or
- Irrelevant and immaterial to the proceedings or
- detrimental to the interest of the company.

C. Time Limit

Minutes book must be written within 30 days of the conclusion of the meeting.

In case of every resolution passed by postal ballot, a brief report on the postal ballot conducted including the resolution proposed, the result of the voting thereon and the summary of the scrutinizer's report shall be entered in the minutes book of general meetings along with the date of such entry within

- thirty days from the date of passing of resolution.

D. Form

- The minutes book shall be bound and its pages should be consecutively numbered.
- A company is permitted to have loose leaf minutes book provided the company takes appropriate safeguard against interpolation of leaves in the minutes book, such as serial numbering of pages, authentication of each page and safe custody of the book.
- The company should also get the loose-leaf minutes bound into books at regular interval.

Note: Every company shall observe Secretarial Standards with respect to general and Board meetings, specified by the Institute of Company Secretaries of India and approved as such by the Central Government.

E. Signature

Each page of every such book shall be initialled or signed and the last page of the record of proceedings of each meeting or each report in such books shall be dated and signed –

i) in the case of minutes of proceedings of a meeting of the Board or of a committee thereof, by the chairman of the said meeting or the chairman of the next succeeding meeting;

ii) in the case of minutes of proceedings of a general meeting, by the chairman of the same meeting within the aforesaid period of thirty days or in the event of the death or inability of that chairman within that period, by a director duly authorised by the Board for the purpose;

iii) In case of every resolution passed by postal ballot, by the chairman of the Board within the aforesaid period of thirty days or in the event of there being no chairman of the Board or the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose.

F. Place and Duration of preservation

Minute book shall be kept at the registered office of the company or it may be kept at some other place as the Board may decide.

The minute book shall be preserved permanently.

G. Presumptions drawn from minutes

Where minutes are kept as per sec. 118 then, until contrary is proved it shall be presumed that

a) The meeting was duly called and held

b) All the proceedings at the meeting were duly taken place

c) All the resolutions passed by postal ballot were duty passed; and

d) In particular all the appointments of directors, key managerial personnel, auditors or company secretary in practice were validly made.

H. Penalty for contravention

If any default is made in complying with the provisions of this section in respect of any meeting, following shall be the liability of Company and office in default

Company	INR 25,000
Every officer of the company who is in default	INR 5,000 for each such refusal or default

If a person is found guilty of tampering with the minutes of the meeting, he shall be punishable with

i) Imprisonment for a term which may extend to 2 years; and

ii) Fine which shall not be less than INR 25,000 but which may extend to INR 1,00,000.

I. Exemption to Section 8 Companies:

In case of Companies covered under section 8, which has not committed a default in filing its financial statements under 137 or Annual Return under section 92 with the Registrar,

- provisions relating to Minutes shall not apply as a whole if company.

However, the minutes may be recorded within 30 days of the conclusion of meeting in every case of companies where articles of association provide for confirmation of minutes by circulation.

13.1. Inspection of Minute Books of General Meeting [Sec 119]

- Minute book shall be open for inspection during business hours for at least 2 hours on every working day.
- It shall be open for inspection by any member without any charge subject to such reasonable restrictions as the company may impose by its Articles or in General Meeting.

Note: Inspection can be carried out only by a member and not by any director or creditor or any other person.

Penalty for contravention

If any inspection is refused by the company to the member, or if the minute- book is not furnished within the specified time, then following shall be the liability

Company	INR 25,000
Every officer of the company who is in default	INR 5,000 for each such refusal or default

Copy of Minutes

a) Hard Copy

A member is entitled to a copy of the minutes of General Meeting within 7 days of his request, and paying the prescribed fees [as per Articles but maximum INR 10 per page or part of page].

b) Soft Copy

A member who has made a request for provision of soft copy in respect of minutes of any previous general meetings held during immediately preceding three financial years shall be entitled to be furnished, with the same free of cost.

14. Maintenance and Inspection of Documents in Electronic Form [Sec. 120]

Electronic form permitted for maintenance inspection and copies of documents etc.	a) Any documents, record, register etc. required to be kept or inspected by a company may be kept or inspected in electronic form. b) Copies of any document, record, register, minutes etc. to be given to any person by a company may be given in electronic form.

Companies prescribed	Following classes of companies may maintain their records in electronic form a) Every listed company b) A company having not less than 1,000 shareholders, debenture holders and other security holders.
Persons responsible for security of records in electronic form	Following person shall be responsible for the maintenance and security of electronic records a) The managing director b) Company secretary c) Any other director or officer of the company as the Board may decide.
Inspection and copies of records maintained in electronic form	▪ The records maintained in electronic from shall be made available for inspection by the company in the electronic form. ▪ Copies of the records maintained in electronic form shall be provided by the company in the electronic form on payment of not exceeding INR 10 per page.

15. Annual General Meeting (AGM) [Sec. 96, 99, 102]

A. Meaning

- It is the regular meeting of members of the company which is held once in every year in addition to other meetings.
- This meeting enables the members to exercise their control over the company and review the management of the company's affairs.
- AGM is an important annual event where members get an opportunity to discuss the activities of the company.

B. Mandatory

Section 96 provides that every company, **other than a one-person company,** is required to hold an annual general meeting every year.

C. Time Limit

First AGM	First AGM of the company should be held within 9 months from the closing of the financial year. Accordingly, it is not necessary for the company to hold any annual general meetings in the year of its incorporation.
Subsequent AGM	Subsequent AGM of the company should be held within 6 months from the closing of the financial year. The gap between two annual general meetings should not exceeds 15 months.

Note: The ROC can, for special reasons, extend time within which the AGM (other than the first AGM) shall be held up to a maximum period of 3 months.

D. Day, place and time

Day	Any day other than a national holiday.
Time	An AGM can be called during business hours i.e. between 9 AM to 6 PM.
Place	Registered office of the company or some other place within the same city, town or village in which the registered of the company is situated.

	However, the Central Government may exempt any class of companies from this provision.

Note: "National Holiday" for this purpose means and includes a day declared as national holiday by the Central Government.

E. Exemption to Section 8 Companies:

In case of Companies covered under section 8, which has not committed a default in filing its financial statements under 137 or Annual Return under section 92 with the Registrar,

- date and place of each annual general meeting are decided upon before-hand by the board of directors having regard to the directions, if any, given in this regard by the company in its general meeting.

F. Punishment for default in complying with the provisions of section 96 to 98–

Section 99 lists out the punishment for contravention of section 96 to 98, i.e. default in holding a meeting of the company as AGM or on the directions issued by the Tribunal. Accordingly, if any default is made

- the company and every officer of the company who is in default
- shall be punishable with fine which may extend to 1,00,000 and
- in case of continuing default with further fine which may extend to INR 5,000/- for each day during which such default continues.

15.1. Business to be Transacted at AGM & EGM [Sec. 102]

i) Ordinary Business

a) Consideration and adoption of the annual accounts and reports of the Board of Directors and Auditors.

b) Declaration of dividends.

c) Appointment and reappointment of directors.

d) Appointment and re-appointment of auditors and fixation of their remuneration.

Note: Ordinary business is conducted only at AGM. No business in EGM shall be deemed as Ordinary Business.

Note: Explanatory statement is not required for transacting any item of ordinary business.

ii) Special business

- Any business, other than ordinary business, scheduled to be transacted at the meeting shall be deemed to be special business.
- It can be transacted in AGM as well as EGM.
- **Full text of the resolution -** Full text of the resolution must be given in the notice for transacting every item of special business.
- **Explanatory statement -** Explanatory statement must be annexed to the notice for transacting every item of special business which must specify,

a) the nature of concern or interest, financial or otherwise, if any, in respect of each items of—

(i) every director and the manager, if any;

(ii) every other key managerial personnel; and

(iii) relatives of the persons mentioned in sub-clauses (i) and (ii);

b) any other information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon.

Where an item of special business which is to be transacted at a meeting of the company

- relates to or affects any other company where
- any promoter, director, manager, or any key managerial personnel of the first mentioned company has
- shareholding of not less than 2% of the paid-up share capital of that company, then the
- extent of shareholding interest of such promoter, director, manager, or KMP in that other company shall also be set out in the statement.

In case of non- disclosure or insufficient disclosure in any statement made by promoter, director, manager or other key managerial personnel which results into any benefit for themselves or their relatives, then the same profit derived shall have to be compensated by him. [Section 102(4)]

In case any item of business refers to any document which is to be considered at the meeting, then the time and place where such document can be inspected should also be specified in the explanatory statement.

iii) Penalty for contravention of section 102

Without prejudice to the provisions of sub-section (4), if any default is made in complying with the provisions of this section,

- every promoter, director, manager or other KMP of the company who is in default shall be liable to a
- penalty of fifty thousand rupees or five times the amount of benefit accruing to the promoter, director, manager or other key managerial personnel or any of his relatives, whichever is higher.

Example 1

Abbeys Private Limited closed its financial year on 31st March 2017. According to section 96(1) of the Act, the Company should hold its annual general meeting for the year 2016-17 by 30th September 2017 unless an extension is granted by RoC on special reasons.

Example 2

Kishan Limited was incorporated on 11th December 2017. When should the company hold its AGM?

According to section 96(1), the company's financial year will close on 31st March 2018. The company may hold its first AGM by 31st December 2018, i.e. within 9 months of the close of its financial year.

16. Report on AGM [Sec. 121]

Applicability	Sec. 121 applies only to listed public companies.
Legal requirements	a) To prepare a report on each AGM in the prescribed manner which shall ➢ confirm that the AGM was convened, held and conducted as per the provisions of this Act and the Rules made thereunder. b) To file with ROC a copy of such report. ▪ The copy shall be filed within 30 days of conclusion of AGM. ▪ The company shall pay such filing fees and such additional fees as may be prescribed.
Manner of preparation of the report	The report on AGM shall be prepared in addition to the minutes of the AGM. The report shall contain fair and correct summary of the proceedings of the AGM.

17. Extraordinary General Meeting (EGM) [Sec. 100]

A. Meaning

A general meeting other than the AGM shall be called as Extraordinary General Meeting.

This meeting is called for transacting some special or urgent business which may arise between 2 AGMs and cannot be postponed till next AGM.

B. Business to be transacted at the meeting

All business to be transacted at EGM is special business. Therefore, every item on the agenda must be accompanied by an explanatory statement.

C. Who may call EGM

i) The Board of Directors; or

ii) The Board on the requisition of the members; or

iii) By the requisitionists themselves.

1) EGM Called by the Board Suo moto

- The Board of Directors may call an EGM whenever it thinks fit.

2) By Board on the requisition of members of the company

a) Minimum number of requisitionists

- In the case of a company having a share capital, holder of not less than 1/10th of the paid-up capital of the company.
- In the case of a company not having a share capital, holder of not less than 1/10th of the total voting power of all the members.

b) Contents of requisition and Explanatory statement

- The requisition shall set out the matters for the consideration of which the meeting is to be called.
- Requisitionists are under no obligation to attach the explanatory statement to the requisition.
- On the receipt of requisition, it is the duty of the Board of Directors to include explanatory statement in the notice of the meeting.

c) Signed

It must be signed by the requisitionists.

d) On requisition, EGM to be called by Board of Directors

On deposit of a valid requisition at company's registered office,

- the directors must move to call a meeting within 21 days; and
- the meeting must be held within 45 days from the date of deposit of requisition.

3) By the requisitionists themselves

a) When

If the Board does not proceed to call the meeting on receiving requisition from the members,

- the requisitionists may themselves proceed to call the meeting
- within 3 months from the deposit of the requisition.

b) Manner of calling EGM

1) The members may requisition convening of an extraordinary general meeting in accordance with section 100(4), by providing such requisition in writing or through electronic mode at least clear twenty-one days prior to the proposed date of such extraordinary general meeting.

2) The notice shall specify the place, date, day and hour of the meeting and shall contain the business to be transacted at the meeting.

   Explanation- For the purposes of this sub-rule, it is here by clarified that requistionists should convene meeting at Registered office or in the same city or town where Registered office is situated and such meeting should be convened on any day except national holiday.

3) If the resolution is to be proposed as a special resolution, the notice shall be given as required by 114(2).

4) The notice shall be signed by all the requistionists or by a requistionists duly authorised in writing by all other requistionists on their behalf or by sending an electronic request attaching therewith a scanned copy of such duly signed requisition.

5) No explanatory statement as required under section 102 need be annexed to the notice of an extraordinary general meeting convened by the requistionists and the requistionists may disclose the reasons for the resolution(s) which they propose to move at the meeting.

6) The notice of the meeting shall be given to those members whose names appear in the Register of members of the company within three days on which the requistionists deposit with the Company a valid requisition for calling an extraordinary general meeting.

7) Where the meeting is not convened, the requistionists shall have a right to receive list of members together with their registered address and number of shares held and the company concerned is bound to give a list of members together with their registered address made as on twenty first day from the date of receipt of valid requisition together with such changes, if any, before the expiry of the forty-five days from the date of receipt of a valid requisition.

8) The notice of the meeting shall be given by speed post or registered post or through electronic mode. Any accidental omission to give notice to, or the non-receipt of such notice by, any member shall not invalidate the proceedings of the meeting.

c) Expenses

Company shall repay all the reasonable expenses incurred by the requisitionists to call the meeting. the sums so paid shall be deducted from any fee or other remuneration under section 197 payable to such of the directors who were in default in calling the meeting.

Judicial decisions

a) An EGM called by Board may be held at any place, even though such place is outside the state in which registered office of the company is situated.

   An extraordinary general meeting of the company, other than of the wholly owned subsidiary of a company incorporated outside India, shall be held at a place within India.

b) Where the Board failed to call the EGM and the meetings were generally held at the registered office of the company but the registered office was not made available to the requisitionists for holding the EGM, holding of EGM elsewhere was held to be valid.

c) An institutional shareholder, like LIC, has the same rights as every other shareholder to requisition an EGM for the purpose of considering removal of a certain number of directors. LIC could not be restrained from calling an EGM on the ground that the reasons for the proposed removal of directors had not been stated in the requisition.

Example 1

The Board of directors of Illusions Private Limited, a company registered in New Delhi, has decided to call an extra-ordinary general meeting in Madrid, Spain on 2nd October 2018. Discuss whether the general meeting can be convened on the said date.

Solution

No, the meeting cannot be convened in the manner as stated in the facts of the question. As per Rule 17(2) of the Companies (Management and Administration) Rules, 2014, the requisitionists should hold the meeting in the registered office of the company or in the same city or town in which the registered office is situated and it should be a working day.

Example 2

The members of the Peacocks Private Limited, holding 1/10th voting power of the company, requisitioned a meeting on 14th August, 2018 to the Board of Directors. However, the directors did not pay any heed to such a requisition and did not call an extra-ordinary meeting. Discuss the consequences of the contravention of the same in accordance with the Companies Act, 2013.

Solution

Where the Board, after the receipt of the requisition, does not within 21 days call for a meeting within 45 days of the date of requisition, then the requisitionists may themselves call and convene the meeting within a period of 3 months from the date of requisition.

18. Tribunal to Call EGM [Sec 98]

Where for any reason it is impractical to call a meeting, other than AGM, the Tribunal may direct the calling of the meeting.

A. Application

Tribunal may call the meeting

- On its own accord; or
- On an application of any director; or
- On an application of any member.

B. Directions

The meeting has to be called in accordance with the directions of the Tribunal regarding place, date and manner of holding the meeting.

C. Quorum

The Tribunal may provide that one-member present in person or proxy shall be deemed to be the quorum for the meeting.

19. Applicability of Chapter VII to OPC [Sec 122]

A. Non-Applicability of certain section

The provisions of section 98 and section 100 to 111 shall not apply to OPC.

B. Manner of passing resolutions:

In case of OPC, for the purpose of transacting any business (whether ordinary or special) at any GM (whether AGM or EGM) by means of any resolution (whether ordinary or special), it shall be sufficient if:

i) the resolution is communicated by the member to the company; and

ii) the resolution is entered in the minutes book; and

iii) the minutes book is signed and dated by the member.

The date of signing the minutes book by the member shall be deemed to be the date of the meeting for all the purpose under this Act.

C. Manner of transacting business required to be transacted in Board Meeting:

In case there is only one director in OPC, any business which is required to be transacted at a Board Meeting, it shall be sufficient if:

i) The resolution is entered in the minutes book; and

ii) The minutes book is signed and dated by such director.

The date of signing the minutes book by the director shall be deemed to be the date of the meeting for all the purpose under this Act.

ARISE AWAKE AND STOP NOT TILL YOUR GOAL IS ACHIEVED

-Swami Vivekanand

About CA Kishan Kumar

- ★ Kishan Kumar is an **Associate member** of The Institute of Chartered Accountants of India.
- ★ He is a **throughout Rankholder** in CA examinations.
- ★ He himself scored **Exemption in EIS-SM** in his CA Inter Exam..
- ★ He has been **awarded by Nitish Kumar, Hon'ble Chief Minister** of Bihar for his excellence in the field of education.
- ★ Internationally renowned **University of South Wales** has also felicitated him for his aptitude and achievements during his academic life.
- ★ Kishan has worked with **Ernst & Young and PwC (Big 4 Firms)** and uses his practical corporate experience to make the subject more interesting and engaging.
- ★ His students have secured **marks as high as 85** and hundreds have scored exemptions.
- ★ He is committed to make meaningful contribution to the life of promising CA aspirants.

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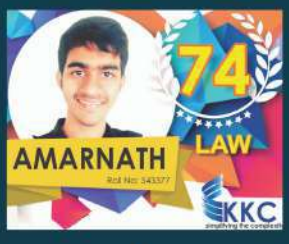

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CHAPTER 8
DECLARATION AND PAYMENT OF DIVIDEND

The pain you feel today is the strength you will feel tomorrow..

1. INTRODUCTION TO DIVIDEND [SEC 2(35)]

Meaning	▪ A dividend is a payment made by a company to its shareholders, usually as a distribution of profits i.e. a portion of profits earned and allocated as payable to the shareholders yearly or whenever declared. ▪ A dividend is allocated as a fixed amount (generally in % or amount) per share, with shareholders receiving a dividend in proportion to their shareholding. **Example** AB Ltd. has issued equity shares having face value of INR 10 per share. The shares are currently quoting on the NSE at INR 250/- per share. The Company at its AGM held on 27.07.2020 has declared a dividend of 20%. Mr. Shekar owns 1000 shares which he purchased at INR 300/- per share. What is the amount of dividend he will receive? The dividend is to be calculated on Face Value i.e., INR 10/-. So, dividend per share is 20% of INR 10/- = 2/- per share. So, Mr. Shekar will receive INR 2 * 1000 shares = INR 2000/-.	
Definition of dividend	▪ Dividend includes any interim dividend [Sec. 2(35)]. ▪ The term 'interim dividend' means the dividend declared between two AGMs.	
Procedure for declaration of dividend	**Final dividend**	▪ When the dividend is declared at the annual general meeting of the company, it is known as Final dividend. ▪ Firstly, dividend is recommended by the Board (Sec. 134). ▪ The members in the AGM may declare the dividend by passing OR. Declaration of dividend at an AGM is an item of ordinary business (Sec. 102). ▪ The members may reduce the rate or amount recommended by the Board, but they cannot increase it (Regulation 80 of table F). **Example** The shareholders at an annual general meeting unanimously passed a resolution for payment of dividend at a rate higher than that

		recommended by the directors. Discuss the validity of the resolution. **Answer** Under regulation 80, the power to declare a dividend vests with the general meeting, But not even all the shareholders have the power to declare a dividend exceeding the amount recommended by the Board of Directors.
	Interim dividend	▪ Interim dividend is declared by the Board.

2. Interim Dividend [Section 2 (35) and Section 123 (3)]

Definition	▪ Dividend includes any interim dividend [sec. 2(35)]	
Meaning	▪ Dividend declared between two AGMs is called as interim dividend. ▪ Interim dividend is recommended and declared by the Board.	
Sources	a) Surplus in P&L account b) Profits of the financial year in which such dividend is sought to be declared; or c) Profits generated in the financial year till the quarter preceding the date of declaration of the interim dividend.	
Restriction on rate of interim dividend	**Where is the restriction applicable**	Where the company has incurred loss during the current FY upto the end of immediately preceding quarter.
	Effect of restriction	The rate of interim dividend shall not exceed the average rate of dividend during preceding 3 FYs.
	Example Wilson Limited is facing loss in business during the current financial year 2016-17. In the immediately preceding three financial years, the company had declared dividend at the rate of 8%, 10% and 12% respectively. To maintain the goodwill of the company, the Board of Directors has decided to declare 12% interim dividend for the current financial year. Is the act of Board of Directors valid? **Answer** 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 [i.e. (8+10+12)/3 =30/3=10%]. Therefore, decision of Board of Directors to declare 12% of the interim dividend for the current financial year is not tenable. They can declare a maximum 10% interim dividend.	
Other points	a) No power is required for declaration of interim dividend. b) Interim dividend shall be paid within 30 days of its declaration. c) Once declared, interim dividend cannot be revoked.	

3. Conditions for Declaration and Payment of Dividend [Sec. 123]

A) Sources of dividend	a) Profits of current FY (after providing for depreciation) b) Undistributed profits of previous FY (s) (after providing for depreciation) c) Moneys provided by CG or SG in pursuance of a guarantee given by it. **Past year losses and depreciation to be set off** Before any dividend is declared, the following shall be set off against the profits of the current year: a) Losses of any previous FY not provided for; and b) Depreciation of any previous FY not provided for. Further, while computing profits, any amount representing unrealised gains, notional gains or revaluation of assets and any change in carrying amount of an asset or of a liability on measurement of the asset or the liability at fair value shall be excluded. **Note:** Depreciation shall be provided in accordance with the provisions of schedule II.
B) Transfer to reserves	▪ Transfer to free reserves is not mandatory. ▪ A company may transfer to free reserves such percentage of its profits as it may deem fit. **Example 1:** Alma Limited proposes to transfer more than 10% of the profits of the company to the reserves for the current year, before the declaration of dividend @ 12%. Is Alma Limited allowed to do so? **Answer:** The amount to be transferred to reserves out of profits for a financial year has been left at the discretion of the company acting vide its Board of Directors. Therefore, the company is free to transfer any part of its profits to reserves as it deems fit. **Example 2:** Brix Limited has earned a profit of Rs. 1,000 crores for the financial year 2016-17. It has proposed a dividend @ 8.75%. However, it does not intend to transfer any amount to the reserves of the company out of the profits earned. Can Brix Limited do so? **Answer:** The amount to be transferred to reserves out of profits for a financial year has been left at the discretion of the company acting vide its Board of Directors. The company is free to transfer any part of its profits to reserves as it deems fit. There is no restriction to transfer any specific amount (i.e., even no amount can be transferred) to the reserves before declaration of dividend.
C) Declaration of dividend out of reserves	If, for any FY, ➢ there is inadequacy or absence of profits, ➢ but a company intends to declare dividend out of accumulated profits of previous FYs ➢ which have been transferred to ***free reserves***, ➢ the company shall comply with the Rules prescribed by CG. **Free Reserves** means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend: The following shall not be treated as free reserves; a) Any amount representing unrealized gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or b) Any change in carrying amount of an asset or of a liability recognized in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value.

Under Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014, such declaration shall be subject to the following conditions:

i) Rate	▪ The rate of dividend declared shall not exceed the average of the rates at which dividend was declared by the company in the immediately preceding 3 FYs. ▪ However, the condition shall not apply to a company, which has not declared any dividend in each of the immediately preceding 3 FYs.
ii) Amount drawn	▪ The total amount to be drawn from reserves shall not exceed 1/10th of the sum of its paid-up share capital and free reserves as per the latest audited FS. ▪ Total amount that can be drawn from accumulated profits ≤10% of (paid up share capital + free reserves) ▪ The amount so drawn from reserves shall first be utilized to set off the losses incurred in FY for which the dividend is declared.
iii) Balance of reserves	▪ The balance of reserves after such withdrawal shall not fall below 15% of its paid-up share capital as per the latest audited FS. ▪ Free Reserves – Amount drawn for payment of dividend >= 15 % of paid-up share capital ▪ Compliance of Rule 3 is not required by a Government Company in which the entire paid-up share capital is held by CG, or by SG(s), or by CG and SG(s).

Example

Capricorn Industries Limited has a paid-up capital of INR 200 lakhs and accumulated Reserves of INR 240 lakhs. Loss for the year ending 31st March 2020 is INR 30 Lakhs. Dividend was declared at the following rates during the three years immediately preceding.

Year 1	9%
Year 2	10%
Year 3	12%

What is the maximum rate at which the company can declare dividend for the current year?

Answer:

In the given case, Capricorn Industries Limited has not made adequate profits during the current year ending on 31st March, 2020, but it still wants to declare dividend. Let us apply the conditions:

Condition I:

$\frac{9+10+12}{3}$ Average rate = = 10.3%

i.e., 10.3% of Paid-up Capital i.e., INR 200 lakhs = INR 20.6 lakhs

Condition II:

Paid-up capital + Free reserves (Assuming all reserves are free) = (200+240) = 440 Lakhs

10% thereof = 44 Lakhs

Less: loss for the year = 30 lakhs

Amount available = 14 lakhs

Hence the quantum of dividend is further restricted to INR 14 lakhs.

Condition III:

	Accumulated Reserves 240 Lakhs Proposed withdrawal declaration of dividend 14 Lakhs **Balance of Reserves 226 Lakhs** This is more than 15% of paid-up capital (i.e 15% of INR 200 Lakhs) i.e., INR 30 lakhs. Thus, the company can declare a dividend of INR 14 lakhs i.e., at a rate of 7% on its paid-up capital of INR 200 lakhs.
Example	Shipra Sugar Mills Limited has been regularly declaring dividend at the rate of 20% on its equity shares for the past 3 years. However, the company has not made adequate profits during the current year ending on 31st March, 2019, but it has got adequate free reserves which can be utilized for maintaining the rate of dividend at 20%. Advise the company as to how it should proceed in the matter if it wants to declare dividend at the rate of 20% for the year 2018-19, as per the provisions of the Companies Act, 2013. **Answer:** In the given case, Shipra Sugar Mills Limited has not made adequate profits during the current year ending on 31st March, 2019, but it still wants to declare dividend at 20%. This can be done out of accumulated profits. Hence, the company can declare a dividend at the rate of 20% subject to the following: The total amount to be drawn from free reserves shall not exceed 10% of its paid-up share capital and free reserves as per the latest audited financial statement. The amount so drawn shall first be utilised to set off the losses incurred in the current financial year and only thereafter, dividend at 20% shall be declared. After such withdrawal from free reserves, the residual reserves shall not fall below 15% of its paid-up share capital as per the latest audited financial statement. The modus operandi will be to get the desired dividend recommended by the Board of Directors and put up the same for the approval of the members at the ensuing Annual General Meeting as the authority to declare dividend lies with the members of the company.
D) Deposit of dividend in separate bank account	a) The amount of the dividend (including interim dividend) shall be deposited in a scheduled bank in a separate account within 5 days of declaration of such dividend. b) Such amount shall not be used for any purpose other than the payment of dividend. **Example** The authorised and paid-up share capital of Avantika Ayurvedic Products Limited is INR 50.00 lacs divided into 5,00,000 equity shares of INR 10 each. At its Annual General Meeting (AGM) held on 24th September, 2019, the company declared a dividend of INR 2 per share by passing an ordinary resolution. The amount of dividend must be deposited in a scheduled bank in a separate account latest by 29th September, 2019.
E) Payment of dividend to whom?	The dividend shall be paid to – a) The registered shareholder of shares; or b) The order of the registered shareholder; or c) The bankers of the registered shareholder.
	Example The Directors of East West Limited proposed dividend at 15% on equity shares for the FY 2018-2019. The same was approved in the Annual general body meeting held on 24th October 2019. The Directors declared the approved dividends. Mr. Binoy was the holder of 2000

	equity of shares on 31st March, 2019, but he transferred the shares to Mr. Mohan, whose name has been registered on 18th June, 2019. Who will be entitled to the above dividend? **Answer:** Dividend shall be payable only to the registered shareholder or to his order or banker. In this case Mr. Binoy is the registered shareholder and therefore it shall be sufficient compliance with the law if the company pays the dividend to Mr. Binoy. **Example** The Director of Som Limited proposed dividend at 12% on equity shares for the financial year 2018-19. The same was approved in the annual general meeting of the company held on 25th June, 2019. Mr. Ninja was the holder of 1,000 equity shares on 31st March, 2019, but he has transferred the shares to Mr. Raj, whose name has been registered on 20th April, 2019. Who will be entitled to the above dividend? **Answer** According to section 123(5), dividend shall be payable only to the registered shareholder of the share or to his order or to his banker. Facts in the given case state that Mr. Ninja, the holder of equity shares transferred the shares to Mr. Raj whose name has been registered on 20th April 2019. Since, Mr. Raj became the registered shareholder before the declaration of the dividend in the Annual general meeting of the company held on 25th June 2019, he will be entitled to the dividend.
Mode of payment of dividend	▪ Dividend shall be payable only in cash (i.e. dividend cannot be paid in kind). ▪ However, the dividend may be paid by cheque / dividend warrant/ electronic mode.
Dividend in proportion to paid-up share capital	Generally, dividend is payable based on face value of shares. However, as per section 51, ➢ a company may, if so authorised by its articles, ➢ pay dividend in proportion to the amount paid-up on each share. Suppose, some of the shareholders have paid only INR 5 (face value INR 10) on each share held by them. In case of declaration of dividend at the rate of INR 5 per share, the company, if authorised by its articles, shall be justified in paying dividend of INR 2.50 per such share which is partly paid.
Capitalisation of profits permitted	It is permissible to capitalise the profits or reserve by- i) Issue of bonus shares; or ii) Making a bonus call.
F) Prohibition on declaration of dividend	**i)** No dividend shall be declared on equity shares, if the company has not complied with- a) Sec. 73 (prohibition on acceptance of deposits from public and condition for acceptance of deposits from the members); or b) Sec. 74 (Repayment of deposit accepted before commencement of CA, 2013). This prohibition shall continue so long as the failure to comply with sec. 73 or 74 continues. **ii) Companies having licence under Section 8** of the Act are prohibited from paying any dividend to its members.

4. Unpaid Dividend Account [Sec. 124]

a) Dividend declared but remaining unpaid- Consequences	**When is transfer required?**	If a dividend is declared but it remains unpaid or unclaimed for 30 days from the date of its declaration.
	Where to transfer?	▪ The amount of unpaid or unclaimed dividend shall be transferred to a special account in any scheduled bank. ▪ Such amount shall be called as 'Unpaid Dividend Account'.
	Time limit for transfer	Such transfer shall be made within 7 days of the expiry of 30 days from the date of declaration of dividend.
	Interest for delayed transfer	▪ Interest @ 12% p.a. is payable by the company for delay in making such transfer. ▪ Such interest shall ensure to the benefit of the members of the company, in proportion to the amount remaining unpaid to term.
b) Statement containing details w.r.t. unpaid dividend to be placed on website	Within 90 days of transfer of amount to the 'Unpaid Dividend account', i) the company shall prepare a statement containing the names, their last known addresses and the amount of unpaid dividend to be paid to each person; and ii) the company shall place such statement- a) On the website of the company, if any; and b) On such other website as may be approved by CG.	
c) Payment from the 'Unpaid Dividend Account'	A person who claims to be entitled to the unpaid dividend transferred to the 'Unpaid Dividend Account' may apply to the company for payment of such amount.	
d) Dividend remaining unpaid in 'Unpaid Dividend Account' – Consequences	**Transfer to fund**	▪ Any money transferred to the 'Unpaid dividend Account' of a company which remains unpaid for 7 years from the date of such transfer shall be transferred by the company to 'Investor Education and Protection Fund' (hereinafter called as the 'Fund'). ▪ Interest accrued, if any, on such money, shall also be transferred to the Fund.
	Furnishing of details	When making a transfer to the Fund, the company shall furnish to the authority administering the said Fund, a statement containing the details of the amount transferred to the Fund.
e) Transfer of shares in the name of the fund	▪ All such shares in respect of which dividend has not been paid or claimed for 7 consecutive years shall be transferred by the company in the name of the Fund. ▪ At the time of such transfer of shares, the company shall also file a statement containing the prescribed details. ▪ In case any dividend is paid or claimed for any year during the said period of 7 years, the shares shall not be transferred to the Fund.	
f) Right to claim the transferred shares	Any person who claims such shares as have been transferred to the Fund, shall be entitled to claim the transfer of shares from the Fund.	

5. Investor Education and Protection Fund [Sec. 125]

Establishment	Sec 125 empowers CG to establish the investor education and protection fund (referred to as the 'Fund').
Credits to the fund	a) Amount in the investor education and protection fund u/s 205C of the Companies Act 1956 b) Amount in the unpaid dividend account of the companies transferred to the fund u/s 124 of the CA, 2013, and interest accrued thereon c) Application money received by the companies for allotment of any securities and due for refund and remaining unpaid for 7 years, and interest accrued thereon d) Matured deposits remaining unpaid for 7 years, and interest accrued thereon e) Matured debentures remaining unpaid for 7 years, and interest accrued thereon f) Redemption amount of preference shares remaining unpaid for 7 years g) Grants by CG h) Donations given to the fund by CG, SG, companies or any other institution i) Income received on the investments made from the Fund j) Sale proceeds of fractional shares arising out of issue of bonus shares, merger and amalgamation and remaining unpaid for a period of 7 years.
Utilization of the Fund	a) Refunds in respect of unclaimed dividends, matured deposits, matured debentures, application money due for refund and interest thereon b) Promotion of awareness among the investors c) Educating the investors d) Protection of the interests of investors e) Distribution of any disgorged amount among persons who have suffered losses f) Reimbursement of legal expenses of class action suits u/s 37 and 245 by members debentures holders or depositors as may be sanctioned by the Tribunal g) Any other incidental purpose.
Claims from the Fund	Any person, who claims to be entitled to any amount transferred to the Fund, may apply to the authority for the money claimed.
Constitution of authority for administration of Fund	CG shall constitute, by notification, an authority for administration of the fund consisting of- i) a chairperson; ii) such other members, not exceeding 7; and iii) a chief executive officer.
Administration of the Fund	▪ The authority shall- a) administer the fund; and b) maintain separate accounts and records in relation to the fund. ▪ The accounts and records shall be maintained in the form prescribed by CG after consultation with CAG.
Powers of the authority	It shall be competent for the authority to spend money out of the fund.
Audit of accounts	▪ The accounts of the Fund shall be audited by the CAG.

	▪ The audited accounts and audit report shall be forwarded annually by the authority to CG.
Annual report of activities of authority	a) The authority shall prepare an annual report. b) The annual reports shall give a full account of its activities during the financial year. c) A copy of the annual report shall be forwarded by the authority to CG. d) The annual reports and the audit report shall be laid before each House of Parliament.

6. Dividend etc. to be Held in Abeyance [Sec. 126]

Applicability of Sec. 126	Sec. 126 applies where- a) a transfer deed is delivered to the company for registration; but b) the transfer of such shares is not registered by the company.
Effect of sec. 126	a) Dividend in relation to such shares shall be transferred to the Unpaid Dividend account. However, if the registered shareholder has authorized the company to pay the dividend to the transferee, the dividend shall not be transferred to the unpaid dividend account but shall be paid to the transferee. b) Any offer of right shares or bonus shares made by the company shall remain pending.
Over-riding effect of sec. 126	Sec. 126 shall apply notwithstanding anything contained in any other provision of the Act.

7. Failure to Distribute Dividends within 30 Days [Sec. 127]

Time limit for payment of dividend	The dividend shall be paid within 30 days from the date of its declaration. In case dividend is paid by issuing dividend warrants, such warrants must be posted at the registered addresses within the prescribed time. Once posted, it is immaterial whether the same are received within thirty days by the shareholders or not.
Punishment for default	a) Punishment for every director, who is knowingly a party to the default: i) **Imprisonment:** Maximum 2 years; and ii) **Fine:** Minimum: INR 1000 per day for each day of default. b) Punishment for the company: Pay simple interest at the rate of 18% per annum.
Exceptions (No default)	a) Where dividend could not be paid by reason of the operation of any law. b) Where a shareholder has given direction to the company regarding payment of dividend, but those directions cannot be complied with, and the same has been communicated to the shareholder. c) Where dividend is lawfully adjusted by the company against any sum due to it from the shareholder. d) Where there is a dispute regarding the right to receive the dividend. e) Where the non-payment of dividend is not due to any default of the company.
Example	Mr. Alok, holding equity shares of face value of INR 10 lakhs has not paid an amount of INR 1 lakh towards call money on shares. Can the same be adjusted against the dividend amount payable to him? **Answer** Yes, as per law, where the dividend is declared by a company and there remains calls in arrears and any other sum due from a member, in such case the dividend can be lawfully adjusted by the company against any sum due to it from the shareholder.

	Thus, company can adjust sum of INR 1 lakh due towards call money on shares against the dividend amount payable to Mr. Alok.

8. Dividend payable on the basis of Nature of Shares

Shares can be classified into two categories i.e. preference shares and equity shares. The manner of payment of dividend is dependent upon the nature of shares.

(i) Preference Shares:

According to Section 43 of the Companies Act, 2013, shareholders holding preference shares are assured of a preferential dividend at a fixed rate during the life of the company.

Dividend is generally cumulative in nature and need not be paid every year in case of deficiency of profits.

Classification of preference shares on the basis of payment of dividend is as follows:

a) **Cumulative Preference Shares:** A cumulative preference share is one that carries the right to a fixed amount of dividend or dividend at a fixed rate.

Such a dividend gets accumulated and its arrears are payable from the profits earned in the later years if the profits of current year are insufficient for payment of dividend.

Until and unless dividend on cumulative preference shares is paid in full, including arrears, if any, no dividend is payable on equity shares.

b) **Non-cumulative Preference Shares:** A non-cumulative preference share carries with it the right to a fixed amount of dividend.

In case no dividend is declared in a year due to any reason, the right to receive such dividend for that year expires. It implies that holder of such a share is not entitled to arrears of dividend in future.

(ii) Equity Shares:

Equity shares are those shares, which are not preference shares. It means that they do not enjoy any preferential rights in the matter of payment of dividend or repayment of capital.

The rate of dividend on equity shares is recommended by the Board of Directors and may vary from year to year.

Rate of dividend depends upon the dividend policy and the availability of profits after satisfying the rights of preference shareholders.

9. Revocation of Dividend

No revocation of dividend	▪ Sec. 127 requires payment of dividend within 30 days of its declaration. ▪ Sec. 127 also covers certain circumstances in which non-payment of dividend within 30 days does not amount to contravention. ▪ Revocation of dividend is not a ground for non- payment of dividend. ▪ Thus, ordinarily a dividend once declared cannot be revoked.
Exceptions	a) Where declarations of dividend are ultra vires (i.e. where dividend is declared although the company has not earned sufficient profits), the declared dividend can be revoked. However, if illegally declared dividend is paid, the directors shall be liable to indemnify the company, i.e. they shall be personally liable. b) Where the company ceases to be a going concern, declared dividend may be revoked.

10. Consequences of Payment of Dividend Out Of Capital

Personal liability of directors	The directors shall be held personally liable to make good to the company the amount distributed as dividend *[Re, Oxford Benefit Building & Investment Society].*
Director's right of indemnity	Directors have a right of indemnity against the members who received dividends knowing that they were being paid dividends out of capital.
No liability of directors	Where dividends improperly paid out of capital have been made good out of subsequent profits, liability ceases to attach to the directors.

11. Difference between Interim Dividend and Final Dividend

Basis	Interim dividend	Final dividend
Definition	Interim dividend is declared and paid during an accounting year, i.e., before the finalization of accounts for the year.	Final dividend is the dividend recommended by the board of directors, and approved by shareholders at the company's Annual General Meeting, after the close of financial year.
Announcement	Announced Board of Directors.	Recommended by Board of Directors and approved by shareholders.
Time of Declaration	Before preparation of financial statements.	After preparation of financial statements.
Revocation	It can be revoked with the consent of all shareholders.	It cannot be revoked.
Provision in Articles of Association	It is declared only when the articles specifically permits the declaration.	It does not require specific provision in articles. any the

ARISE AWAKE AND STOP NOT TILL YOUR GOAL IS ACHIEVED

-Swami Vivekanand

About CA Kishan Kumar

- ★ Kishan Kumar is an **Associate member** of The Institute of Chartered Accountants of India.
- ★ He is a **throughout Rankholder** in CA examinations.
- ★ He himself scored **Exemption in EIS-SM** in his CA Inter Exam..
- ★ He has been **awarded by Nitish Kumar, Hon'ble Chief Minister** of Bihar for his excellence in the field of education.
- ★ Internationally renowned **University of South Wales** has also felicitated him for his aptitude and achievements during his academic life.
- ★ Kishan has worked with **Ernst & Young and PwC (Big 4 Firms)** and uses his practical corporate experience to make the subject more interesting and engaging.
- ★ His students have secured **marks as high as 85** and hundreds have scored exemptions.
- ★ He is committed to make meaningful contribution to the life of promising CA aspirants.

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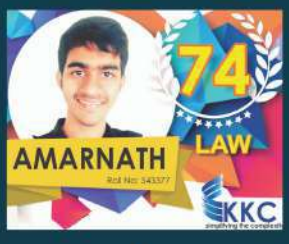

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CHAPTER 9
ACCOUNTS OF COMPANIES

The Expert in Everything was Once a Beginner.

1. INTRODUCTION

There is a need for disclosing the Annual information to the shareholders by the directors about the working and financial position of the company, so that the shareholders are aware of the affairs of the company. So, the Companies Act, 2013, lays down the various provisions related to maintenance of proper books of account etc. of the companies through required compliances.

2. MEANING, LOCATION, MANNER, PERIOD OF MAINTENANCE AND INSPECTION OF BOOKS OF ACCOUNT [SEC 2(13) AND 128]

Definition/Meaning	Books of accounts includes records maintained in respect of a) all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place; b) all sales and purchases of goods and services by the company; c) the assets and liabilities of the company; and d) 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.
Preparation of books of account etc.	▪ Every company shall prepare and keep books of account and other relevant books and papers and financial statements (hereinafter referred to as 'books of account etc.') for every FY. ▪ 'Book and paper' and 'book or paper' include book of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form *[clause (12) of sec. 2].*
Method/manner of preparation	The books of account etc. must- a) give a true and fair view of the state of the affairs of the company, including its branch office(s); b) Explain the transactions effected at the registered office and its branch office (s); c) Be prepared on accrual basis; d) Be prepared according to the double entry system of accounting.

<table>
<tr><td>Manner of maintenance of books of account etc. in electronic form</td><td colspan="2">The books of account and other relevant papers may be kept in electronic mode in such manner as may be prescribed.

Rule 3 of the Companies (Accounts) Rules, 2014 prescribes the following manner:

a) The books of account etc. shall remain accessible in India.

b) The books of account etc. shall be retained completely in the original format, or in a format which shall present accurately the information generated, sent or received.

c) The information contained in the electronic records shall remain complete and unaltered.

d) The information contained in the electronic records shall be legible.

e) There shall be proper system for storage, retrieval, display or printout of the electronic records.

f) The electronic records shall not be disposed off unless permitted by law.

g) The back-up of the electronic records shall be kept in servers physically located in India on a periodic basis.

h) The company shall intimate to the registrar on an annual basis-

i) the name of the service provider;

ii) the internet protocol address of service provider;

iii) the location of the service provider (wherever applicable);

iv) Where the books of account etc. are maintained on cloud, such address as is provided by the service provider.</td></tr>
<tr><td rowspan="3">Location of books of account etc.</td><td>Registered office</td><td>▪ The books of account etc. shall be kept at the registered office of the company.</td></tr>
<tr><td>Any other place in India</td><td>▪ All or any of the books of account etc. may be kept at such other place in India as the Board of Directors may decide.

▪ In such a case, the company shall file with the registrar a notice containing the full address of such other place. The notice shall be filed, within 7 days, in Form No. AOC-5.</td></tr>
<tr><td>Books of Accounts - Branch office</td><td>▪ Where a company has a branch office (whether in India or outside India), the books of account etc. relating to the transactions effected at the branch office may be kept at the branch office.

▪ In such a case, proper summarized returns must be periodically sent by the branch office at-

i) The registered office of the company; or
ii) such other place where books of account etc. are kept.</td></tr>
<tr><td>Preservation of books of account</td><td colspan="2">Every company shall preserve in good order the books of accounts together with the relevant vouchers for a period-

a) not less than 8 FYs immediately preceding the relevant FY; or

b) if the company has been in existence for less than 8 FYs, then, for the entire period of its existence.</td></tr>
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<table>
<tr><td></td><td colspan="2">c) where an investigation of the company is ordered, CG may direct that the books of account shall be kept for such longer period as may directed by CG.

Note: Provisions of Income Tax Act shall also be complied.</td></tr>
<tr><td>Inspection of books of account</td><td colspan="2">a) The books of account etc. maintained within India shall be open for inspection by any director-

➢ at the registered office of the company or at such other place in India where the books have been kept;

➢ during business hours.

b) Financial information maintained outside India may be inspected by any director subject to such conditions as may be prescribed.

Provisions contained in Rule 4 of the Companies (Accounts) Rules, 2014:

1) The summarised returns of the books of account of the company kept and maintained outside India shall be sent to the registered office at quarterly intervals. Such summarised returns shall be kept and maintained at the registered office of the company and kept open to directors for inspection.

2) Where any other financial information maintained outside the country is required by a director, the directors shall furnish a request to the company setting out the full details of the financial information sought and the period for which such information is sought.

3) The company shall produce such financial information to the director within 15 days of the date of receipt of the written request.

4) The financial information required under sub-rules (2) and (3) shall be sought for by the director himself and not by or through his power of attorney holder or agent or representative.

c) The inspection of books of account of any subsidiary company shall be made only by the person authorised by a resolution of the Board of Directors.

d) It shall be the duty of every officer and employee of the company to give to the person making inspection all reasonable assistance in connection with the inspection.</td></tr>
<tr><td rowspan="2">Persons responsible and penalty</td><td>Persons responsible</td><td>i) Managing director
ii) Whole-time director in charge of finance
iii) Chief Financial Officer
iv) Any other person of a company charged by Board with such duty.</td></tr>
<tr><td>Punishment for contravention</td><td>i) Imprisonment up to 1 year; or
ii) Fine: Minimum INR 50,000; Maximum INR 5, 00,000.
iii) Both.</td></tr>
<tr><td>Example</td><td colspan="2">XYZ Ltd. wants to maintain its books of account on cash basis. Is this a valid act of XYZ?

Answer

The Companies Act, 2013 vide section 128(1) now requires every company to prepare books of account and other relevant books and papers and financial statement for every financial year shall be kept on accrual basis and according to the double entry system of accounting.

Further, section clearly states that the books of accounts must be maintained on accrual basis and according to the double entry system of accounting. No exception has been given</td></tr>
</table>

	by the Act to any class or classes of companies from the above requirement. Hence, it is clear that XYZ Ltd. cannot maintain its books of accounts on cash basis.

3. Financial Statement [Sec 2(40) and Sec 129]

Definition	Financial Statements' in relation to a Company, includes- i) Balance sheet at the end of the FY; ii) Profit and loss account for the FY (In the case of a company carrying on any activity not for profit, an income and expenditure account for the FY); iii) Cash flow statement for the FY; iv) 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 statements, with respect to One Person Company, small company, dormant company and private company (if such private company is a start-up) may not include the cash flow statement. Explanation. For the purposes of this Act, the term 'start-up' or 'start-up company' means a private company incorporated under the companies Act, 2013 or the companies Act 1956 and recognised as start-up in accordance with the Notification issued by Department of Industrial Policy and Promotion, Ministry of Commerce and Industry
Legal requirements w.r.t. financial statements [sec. 129(1)]	a) The FS shall give a true and fair view of the state of affairs of the company. b) The FS shall comply with the Accounting Standards notified u/s 133. If the FS do not comply with the Accounting Standards, the company shall disclose in its FS: i) the deviation from the AS; ii) the reasons for such deviation; and iii) the financial effects, if any, arising out of such deviation. c) The FS shall be in the form or forms as may be provided for different class or classes of companies in schedule III. d) Where a company has one of more subsidiaries or associate companies, it shall also prepare consolidate financial statement of the company and of all the subsidiaries and associate companies in the same form and manner as that of its own. e) The provisions relating to the preparation, adoption and audit of the FS of a holding company shall, mutatis mutandis, apply to the consolidated financial statement. f) Further, 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 and associate company or companies in such form as may be prescribed.
Non-applicability	Nothing contained in sec 129(1) shall apply to- a) any insurance company; or b) any banking company: or c) any company engaged in the generation or supply of electricity; or d) any other class of company for which a form of FS has been specified in the Act governing such class of company.

	Thus, even if such companies do not disclose matters which are not required to be disclosed by their governing statutes, still it shall be treated as True and Fair FS. **Note:** Section 129 shall not apply to the Government Companies engaged in defence production to the extent of application of relevant Accounting Standard on segment reporting.
Laying of financial statements	At every annual general meeting, the Board shall lay the following documents: a) FS of the company; and b) Consolidated financial statement of the company and of all the subsidiaries, if any.
Form and items contained in financial statements	Rules 4A of the Companies (Accounts) Rules, 2014 makes the following provisions: a) The financial statement shall be in the form specified in schedule III to the Act and comply with AS or Indian Accounting Standards, as applicable. b) The items contained in the financial statement shall be prepared in accordance with the definitions and other requirements specified in the accounting standard or the Indian According Standards, as the case may be.
Consolidated financial statements	a) The Consolidate financial statements which are required to be laid before the AGM, shall be prepared in the same form and same manner in which the financial statement of the company are prepared. b) CG may provide for the consolidation of FS of companies in such manner as may be prescribed. Rule 6 of the Companies (Accounts) Rules, 2014 lays down the following provisions: i) The consolidation of financial statements of the company shall be made in accordance with the provisions of schedule III of the Act and the applicable AS. ii) If a company is not required to prepare CFS under the AS, it shall be sufficient if the company complies with the provisions contained in Schedule III of the Act. iii) Preparation of CFS shall not be required if all the following conditions are satisfied: a) The company is a wholly-owned subsidiary or is a partially-owned subsidiary of another company and all its other members, having been intimated in writing and for which the proof of delivery of such intimation is available with the company, do not object to the company not preparing the CFS. b) It is a company whose securities are not listed and are not in the process of listing on any stock exchange, whether in India or outside India. c) Its ultimate or any intermediate holding company files CFS with the Registrar which follow the applicable AS.
Statement containing salient features of the subsidiary	The company shall also attach along with its FS, a separate statement containing the salient features of the FS of its subsidiary or subsidiaries in such form as may be prescribed, viz. Form No. AOC-1, as per Rule 5.
Exemption	a) CG may, by notification, exempt any class or classes of companies from complying with any of the requirements of this section or this section or the rules made thereunder. b) CG may grant such exemption on its own or an application by a class or classes of companies. c) CG may grant such exemption if it considers necessary to grant such exemption in the public interest.

	d) Such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification.
Notes	For the purposes of sec. 129, any reference to the financial statement shall include any notes annexed to such financial statement.
Persons responsible and penalty	a) Following persons shall be held responsible for ensuring compliance of the provisions of this section: i) Managing director ii) Whole-time director in charge of finance iii) Chief Financial Officer iv) Any other person of a company charged by the Board with such duty v) All the directors, in the absence of any of the officers mentioned above. b) In case of non-compliance of any of the provisions of this section, all such persons shall be liable to – i) imprisonment upto 1 year; or ii) fine: Minimum INR 50,000; Maximum INR 500,000; or iii) both.
Example 1	Suppose if A Ltd. is wholly owned subsidiary of B Ltd. Here in this case B Ltd. will consolidate financials of A Ltd. Now suppose, if A Ltd. has one subsidiary i.e. B Ltd. & one associate company i.e. C Ltd. B Ltd. is the entity incorporated outside India and C Ltd is the entity incorporated in India. Here in the given case, A Ltd. will consolidate financial statement of both B and C Ltd. A Ltd. shall also attach the financial statement of B Ltd. along with filing of consolidated financials of A Ltd. Also, a statement containing the salient features of the financial statement of a company's subsidiary, associate or joint venture shall be filed as an annexure to the board's report. The word 'Subsidiary' includes Associate Company and joint venture.
Example 2	The Board of Directors of ABC Ltd. wants to circulate unaudited accounts before the Annual General Meeting of the shareholders of the Company. Whether such an act of ABC Ltd. is tenable? **Answer** Section 129(2) of the Companies Act, 2013 provides that 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. Further section 134(7) provides that signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of: a) any notes annexed to or forming part of such financial statement; b) the auditor's report; and c) the Board's report. It, therefore, follows that unaudited accounts cannot be sent to members or unaudited accounts cannot be filed with the Registrar of Companies. So, such an act of ABC Ltd is not tenable.

4. Re-opening of Accounts on Court's or Tribunal's Orders [Sec 130]

Conditions for re-opening the books of account and recasting the FS	a) An application shall be made to the Court or Tribunal by- i) CG; or ii) SEBI; or iii) the income-tax authorities; or iv) any other statutory regulatory body or authority; or v) any person concerned. b) An order is made by a Court or the Tribunal to the effect that- i) The relevant earlier accounts were prepared in a fraudulent manner; or ii) The affairs of the company were mismanaged during the relevant period, because of which doubts are raised as to whether the FS are reliable or not. c) Before passing any order, the Court or the Tribunal shall give notice to, and shall take into consideration the representations, if any, made by, - i) CG; ii) The Securities and Exchange Board of India; iii) The Income-tax authorities; iv) any other statutory regulatory body or authority concerned.
Maximum number of years for reopening of books	▪ No order shall be made under this section in respect of re-opening of books of account relating to a period earlier than eight financial years immediately preceding the current financial year. ▪ However, where a direction has been issued by the Central Government for keeping of books of account for a period longer than eight years, the books of account may be ordered to be re-opened within such longer period.
Recast accounts to be final	The accounts revised or re-cast u/s 130 shall be final.

5. Voluntary Revision of Financial Statements or Board's Report [Sec 131]

Conditions for voluntary revision	The Board of Directors may decide to prepare the revised FS or a revised Board's Report, if the following conditions are satisfied: a) The Board is of the opinion that- i) the FS do not comply with the provisions of sec. 129; or ii) The Board's Report does not comply with the provisions of sec. 134. b) The financial statements or the Board's Report may be revised only in respect of any of the preceding 3 financial years. c) The revisions of the financial statements or the Board's Report may be made only after obtaining the approval of the Tribunal. ➢ For this purpose, the company shall make up an applicable to the Tribunal in such form and manner as may be prescribed. ➢ Before passing any order, the Tribunal shall give notice to CG and Income Tax Authorities, and shall take into consideration the representations, if any, made by CG and Income tax Authorities. ➢ The copy of the order of the Tribunal shall be filed with the Registrar.

Number of times of revision and recast	▪ The revised financial statements or the revised Board's Report shall not be prepared more than once in a financial year.
Reason for revision to be disclosed	▪ The detailed reasons for revision of the financial statements or the Board's Report shall be disclosed in the Board's Report prepared for the relevant financial year, viz. the financial year in which such revision is made.
Limits of revision	▪ Where copies of the previous financial statements or Board's Report have been sent out to members or delivered to the Registrar or laid before the company in GM, the revisions must be confined to – i) the correction in respect of which the previous financial statements or Board's Report do not comply with the provisions of Sec. 129 or sec. 134; and ii) the making of any necessary consequential alteration.
Power of the Central Government to make Rules	CG may make rules as to the application of the provisions of this Act in relation to revised financial statement or a revised Board's Report. Such rules may, in particular- a) make different provisions according to which the previous financial statements or Board's Report are replaced or are supplemented by a document indicating the corrections to be made; b) make provisions with respect to the functions of the company's auditor in relation to the revised financial statement or Board's report; c) require the directors to take such steps as may be prescribed.

6. Central Government to Prescribe Accounting Standards [Sec 133]

Power with whom?	The power to prescribe the accounting standards vests with CG.
Stages in prescribing AS	Stages in prescribing the AS are as follows: i) At the first stage, the Institute of Chartered Accountants of India (ICAI) recommends the Standards of Accounting. ii) At the second stage, these Standards of Accounting shall be examined by the National Financial Reporting Authority (NFRA). NFRA may also make its own recommendations. iii) At the third stage, CG examines the recommendations made by NFRA. Then, CG may prescribe, after consultation with NFRA, the AS.
Forms and items contained in financial statements	▪ The financial statements shall be in the form specified in schedule III to the Act and comply with AS or Indian Accounting Standards as applicable. ▪ The items contained in the financial statements shall be prepared in accordance with the definitions and other requirements specified in the AS or the Indian Accounting Standards, as the case may be [Rule 4A of the Companies (Accounts) Rules, 2014].

7. Constitution of National Financial Reporting Authority (NFRA) [Sec. 132]

Method of constitution	▪ CG may, by notification, constitute a National Financial Reporting Authority to provide for matters relating to accounting and auditing standards under this Act. ▪ The National Financial Reporting Authority shall perform its functions through such divisions as may be prescribed. ▪ Each division of the National Financial Reporting Authority shall be presided over by the Chairperson or a full-time Member authorised by the Chairperson.

Constitution (3)

NFRA shall consist of

- a chairperson, who shall be a person of eminence and having expertise in accountancy, auditing, finance or law to be appointed by CG and
- such other members not exceeding 15 consisting of part-time and full-time members as may be prescribed.

The chairperson and members shall make a declaration to CG in the prescribed form regarding no conflict of interest or lack of independence in respect of his or their appointment

The chairperson and members,

- who are in full-time employment with NFRA
- shall not be associated with any audit firm (including related consultancy firms)

during the course of their appointment and 2 years after ceasing to hold such appointment.

Functions (2)

NFRA shall –

(a) make recommendations to CG 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

(d) perform such other functions relating to clauses (a), (b) and (c) as may be prescribed.

Power (4)

NFRA shall -

(a) have the power to investigate, either suo moto or on a reference made to it by CG, for such class of bodies corporate or persons, in such manner as may be prescribed into the matters of professional or other misconduct committed by any member or firm of chartered accountants, registered under the Chartered Accountants Act, 1949

Provided that no other institute or body shall initiate or continue any proceedings in such matters of misconduct where NFRA has initiated an investigation under this section;

(b) have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely –

i) discovery and production of books of account and other documents, at such place and at such time as may be specified by NFRA;
ii) summoning and enforcing the attendance of persons and examining them on oath;
iii) inspection of any books, registers and other documents of any person referred to in clause (b) at any place;
iv) issuing commissions for examination of witnesses or documents;

(c) Where professional or other misconduct is proved, have the power to make order for -

(A) imposing PENALTY of –

In case of	Minimum	Maximum
Individuals	INR 1 Lakhs	5 times of the fees received
Firms	INR 5 Lakhs	10 times of the fees received

(B) DEBARRING the member or the firm from engaging himself or itself from being

	appointed as i) an auditor or internal auditor or undertaking any audit of any company or body corporate; or ii) performing any valuation as provided under section 247 for a minimum period of 6 months or for such higher period not exceeding 10 years as may be decided by NFRA. **Explanation -** For the purposes of his sub-section, the expression "professional or other misconduct" shall have the same meaning assigned to it under section 22 of the Chartered Accountants Act, 1949.
Appeal against orders of NFRA	Any person aggrieved by any order of the NFRA may prefer an appeal before the Appellate Tribunal in such manner and on payment of such fee as may be prescribed.
Head office of NFRA	The head office of the NFRA shall be at New Delhi and the National Financial Reporting Authority may, meet at such other places in India as it deems fit.
Maintenance of books by NFRA	The NFRA shall cause to be maintained such books of account and other books in relation to its accounts in such form and in such manner as the Central Government may, in consultation with the Comptroller and Auditor-General of India prescribe.
Audit of account of NFRA	The accounts of the NFRA shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him. Such accounts as certified by the Comptroller and Auditor-General of India together with the audit report thereon shall be forwarded annually to the Central Government by NFRA.
Annual Report on working of NFRA	NFRA shall prepare its annual report giving a full account of its activities during the financial year and forward a copy thereof to the Central Government. Central Government shall cause the annual report and the audit report given by the Comptroller and Auditor-General of India to be laid before each House of Parliament.
NFRA Rules, 2018	NFRA shall have power to monitor and enforce compliance with accounting standards and auditing standards, oversee the quality of service under sub-section (2) of section 132 or undertake investigation under sub-section (4) of such section of the auditors of the following class of companies and bodies corporate: a) companies whose securities are listed on any stock exchange in India or outside India; b) unlisted public companies having ➢ paid-up capital of not less than rupees five hundred crores or ➢ annual turnover of not less than rupees one thousand crores or ➢ outstanding loans, debentures and deposits, in aggregate, of not less than rupees five hundred crores ➢ as on the 31st March of immediately preceding financial year; c) insurance companies, banking companies, companies engaged in the generation or supply of electricity, companies governed by any special Act for the time being in force; d) any body corporate or company or person, or any class thereof, on a reference made to the NFRA by the Central Government in public interest; and e) a body corporate incorporated or registered outside India, which is a subsidiary or associate company of any company or body corporate incorporated or registered in India as referred to in clauses (a) to (d) above, ➢ if the income or net-worth of such subsidiary or associate company ➢ exceeds 20% of the consolidated income or consolidated net worth of such company or the body corporate, as the case may be, referred to in clauses (a) to (d)

	above. A company or a body corporate other than a company governed under NFRA Rules shall continue to be governed by the NFRA for a period of 3 years after it ceases to be listed or its paid-up capital or turnover or aggregate of loans, debentures and deposits falls below the limit stated therein (i.e. mentioned in points a to e above). **Recommending accounting standards (AS) and auditing standards (SA) -** For the purpose of recommending AS or SA for approval by the Central Government, the NFRA - a) shall receive recommendations from the ICAI on proposals for new AS or SA or for amendments to existing AS or SA; a) may seek additional information from the ICAI on the recommendations received under clause (a), if required. The NFRA shall consider the recommendations and additional information in such manner as it deems fit before making recommendations to the Central Government.

8. Financial Statement, Board's Report, Etc. [Sec 134]

Section 134 deals with financial statements as well as board's report. The auditor's report is to be attached to every financial statement.

A report by the Board of directors containing details on the matters specified, including director's responsibility statement, shall be attached to every financial statement laid before company. The Board's report and every annexure has to be duly signed.

A signed copy of every financial statement shall be circulated, issued or published along with all notes or documents, the auditor's report and Board's report.

Contents of Board's Report [Sec. 134(3)]	Board's Report shall be attached to the financial statements laid before the company in GM. The Board's report shall include the following matters: a) The web address, if any, where annual return referred to in section 92 has been placed b) Numbers of meetings of the Board. c) Director's Responsibility Statement [for the contents of DRS, refer to sec. 134(5)]. d) Details in respect of frauds reported by auditors u/s 143(12) other than those which are reportable to CG. e) A statement on declaration given by independent directors [as per sec. 149(7)]. f) In case of a company which is required to constitute the Nomination and Remuneration Committee (as per sec. 178), company's policy on directors' appointment and remuneration including criteria for determining qualification, positive attributes, independence of a director and other matters provided u/s 178. In the case of a Government Company, this disclosure is not required [Notification No. G.S.R. 463 (E) dated 5th June, 2015]. g) Explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made- i) by the auditor in his report; and ii) by the company secretary in practice in his secretarial audit report. h) Particulars of loans, guarantees or investments u/s 186.

	i) Particulars of contracts or arrangements with related parties referred to in sec. 188 in Form AOC-2. j) The state of the company's affaires. k) The amounts, if any, proposed to be transferred to the reserves. l) The amount of dividend proposed/recommended by the Board. m) Material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the FY of the company to which the FS relate and the date of Board's Report. n) The conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed. o) 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. p) The details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year. q) A statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors, if- ▪ the company is a listed company; or ▪ the company is a public company having paid-up share capital of INR 25 crore or more as at the end of the preceding FY. r) In case of a Government company, this disclosure is not required if the directors are evaluated by the Ministry or Department of CG which is administratively in charge of the company, or, as the case may be, SG, as per its own evaluation methodology [Notification No. G.S.R. 463 € dated 5th June, 2015]. s) Such other matters as may be prescribed (discussed later). **Note:** In case of following policies, it shall be sufficient compliance if i) the policy is made available on company's website, if any, and ii) salient features of the policy and any change therein are specified in brief in the Board's Report and iii) the web-address is indicated therein at which the complete policy is available. **A.** In case of a company which is required to constitute the Nomination and Remuneration Committee (as per sec. 178), company's policy on directors' appointment and remuneration including criteria for determining qualification, positive attributes, independence of a director and other matters provided u/s 178. **B.** The details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year.
Contents of director's responsibility statement [Sec. 134(5)]	Directors' responsibility statement is aimed at highlighting the accountability of the directors with a view to ensuring good corporate governance. It will make the directors accountable to safeguard the assets of the company and to take positive steps in this regard. The directors' responsibility statement shall disclose the following particulars: a) Whether the applicable AS had been followed in the preparation of FS. In case of any material departures, proper explanation shall be given.

	b) Whether the director had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company and of the profit and loss of the company. c) Whether the directors had taken proper and sufficient care- ➢ for the maintenance of adequate accounting records in accordance with the provisions of this Act; ➢ for safeguarding the assets of the company; and ➢ for preventing and detecting fraud and other irregularities. d) Whether the directors had prepared the FS on a going concern basis. e) Whether the directors had laid down internal financial controls to be followed by the company and whether such internal financial controls are adequate and were operating effectively, if the company is a listed company. The term "internal financial controls" means the policies and procedures adopted by the company for ensuring- ➢ orderly and efficient conduct of business, including adherence to Co's polices, ➢ the safeguarding of its assets, ➢ the prevention and detection of frauds and errors, ➢ the accuracy and completeness of the accounting records, and ➢ the timely preparation of reliable financial information. f) Whether the directors had devised proper system to ensure compliance with the provisions of all applicable laws and whether such system were adequate and operating effectively.
Other matters prescribed	As per Rule 8(5) of the Companies (Accounts) Rules 2014, following other matters shall also be disclosed in the Board's report of every company: i) The financial summary or highlights. ii) The change in the nature of business, if any. iii) The details of directors or key managerial personnel who were appointed or have resigned during the year. iv) The name of companies which have become or ceased to be its subsidiaries, joint ventures or associate companies during the year. v) The details relating to deposits, covered under Chapter V of the Company Act, 2013- a) Accepted during the year; b) Remained unpaid or unclaimed as at the end of the year; c) Whether there has been any default in repayment of deposits or payment of interest thereon during the year and if so, number of such cases and the total amount involved- - At the beginning of the year; - Maximum during the year; - At the end of the year.

	vi) The details of deposits which are not in compliance with the requirements of Chapter V of the Companies Act, 2013. vii) The details of significant and material orders passed by the Regulators or Courts or Tribunals impacting the going concern status and company's operations in future. viii) The details in respect of adequacy of internal financial controls with reference to the financial statement. ix) a disclosure, as to whether maintenance of cost records as specified by the CG under section 148(1) of the Companies Act, 2013, is required by the Company and accordingly such accounts and records are made and maintained, x) a statement that the company has complied with provisions relating to the constitution of Internal Complaints Committee under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013
Scope of Board's Report	▪ As per Rule 8(1) of the Companies (Accounts) Rules, 2014, the Board's Report shall be prepared based on the stand-alone financial statements of the company. ▪ The Board's Report shall contain a report on the highlights of performance of subsidiaries, associates and joint venture companies and their contribution to the overall performance of the company during the period under report.
Board's Report in case of One Person Company and Small Company [Sec. 134(4)]	▪ The Board's Report of OPC and Small Company shall be prepared based on the **stand-alone financial statement** of the company, which shall be in abridged form and contain the following – a. the web address, if any, where annual return referred to in section 92(3) has been placed; b. number of meetings of the Board; c. Directors' Responsibility Statement as referred to in section 134(5); d. details in respect of frauds reported by auditors under section 143(2) other than those which are reportable to the Central Government; e. explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report; f. the state of the company's affairs; g. the financial summary or highlights; h. material changes from the date of closure of the financial year in the nature of business and their effect on the financial position of the company; i. the details of directors who were appointed or have resigned during the year; j. the details or significant and material orders passed by the regulators or courts or tribunals impacting the going concern status and company's operations in future. k. The Report of the Board shall contain the particulars of contracts or arrangements with related parties referred to in section 188(1) in the Form AOC-2.
Signing of Board's Report [134(6)]	a) The Board's Report and any annexures thereto shall be signed by- i) The chairperson of the company, if he is authorized by the Board; or ii) At least 2 directors one of whom shall be a managing director, if the chairperson of the company is not so authorized.

9. Approval and Signing of Financial Statements [Sec 134(1) & (2)]

Approval	The financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board.
Signing	a) The financial statement, including consolidated financial statement, if any, shall signed on behalf of the Board, at least by- i) The chairperson of the company, where he is authorized by the Board, or 2 directors, one of whom shall be the managing director; ii) Chief Executive Officer; and iii) Chief Financial Officer, wherever he is appointed; and iv) Company Secretary, wherever he is appointed. b) In the case of a OPC, the financial statement, including consolidated financial statement, if any, shall be signed by one director only.
Submission	The financial statements, including consolidated financial statements, if any, shall be submitted to the auditor after they have been approved and signed.
Attachment of auditor's report [Sec. 134(2)]	The auditor's report shall be attached to every financial statement.
Issue, circulation or publication of various documents [Sec. 134(7)]	A singed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy of- a) Any notes annexed to or forming part of such FS; b) The auditor's report; and c) The Board's report.
Example 1	XYZ is the company who has not prepared and filed statements for the last 5 years, whether the current directors can sign all the financial statements for the past 5 years? **Answer** As per section 134 (1), the financial statements of the company shall be signed by the chairperson of the company where he is authorised by the Board; or two directors out of which one shall be managing director and other the Chief Executive Officer, if he is a director in the company, the Chief Financial Officer; and the company secretary of the company, wherever they are appointed. Therefore, if the financial statements are being prepared for the last 5 years in the current year, the current directors can sign the financial statements for the last 5 years. However, company can approach the Tribunal for compounding of offences for not holding the AGM's for the past 5 years and for non-filing of the financial statement for such periods.
Example 2	ABC Company is a one-person company and has only one director. Who shall authenticate the balance sheet and statement of profit & loss and the Board 's report? **Answer** In case of a One Person Company, the financial statements shall be signed by only one director, for submission to the auditor for his report thereon. So, the financial statements signed by one director shall be considered in order.

10. Corporate Social Responsibility [Sec 135]

Definition of CSR	Rule 2 of the Companies (CSR Policy) Rules, 2014 defines CSR as follow: 'Corporate Social Responsibility (CSR)' means and includes but is not limited to-

	i) Projects or programs relating to activities specified in schedule VII to the Act; or ii) Projects or programs relating to activities undertaken by the Board of directors of a company in pursuance of recommendations of the CSR Committee of the Board as per declared CSR Policy of the company subject to the conditions that such policy will cover subjects enumerated in schedule VII of the Act.
Applicability	a) Sec. 135 applies to a company (including a foreign company) only if it satisfies one or more of the following criteria during the *immediately preceding financial year*: i) The net worth of the company is INR 500 crore or more. ii) The turnover of the company is INR 1,000 crore or more. iii) The net profit of the company is INR 5 crore or more. b) Every company which ceases to fulfil the above criteria for 3 consecutive FYs shall not be required to- i) Constitute CSR committee; and ii) Comply with the provisions contained in sec. 135 till such time it meets the criteria specified above.
Constitution of CSR committee	a) Every company to which sec. 135 is applicable, shall constitute a Corporate Social Responsibility committee of the Board (CSR committee). b) The CSR committee shall consist of 3 or more directors out of which at least 1 director shall be an independent director. "Provided that where a company is not required to appoint an independent director under section 149(4), it shall have in its CSR Committee two or more directors." c) In case of a foreign company, the CSR committee shall comprise of ➢ at least 2 persons ➢ of which one person shall be a person resident in India authorized to accept on behalf of the foreign company service of notices and other documents, and ➢ the other person shall be nominated by the foreign company.
Duties of the CSR Committee	The CSR Committee shall a) formulate and recommend to the Board, a CSR policy which shall indicate the activities to be undertaken by the company in areas or subject specified in Schedule VII. b) recommend the amount of expenditure to be incurred on the CSR activities to be undertaken by the company. c) Monitor the CSR policy from time to time.
Duties of Board	The Board shall a) ensure that the activities as are included in CSR Policy of the company are undertaken by the company; b) ensure that the company spends in every FY, at least 2% of the average net profits of the company made during the 3 immediately preceding FYs in pursuance of its CSR policy. **Note:** The company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for CSR activities.
Contents of the CSR Policy	a. List of CSR projects or programs which a company plans to undertake falling within the purview of the Schedule VII of the Act, specifying modalities of execution of such project or

	programs and implementation schedules for the same; and b. monitoring process of such projects or programs: c. Provided further that the Board of Directors shall ensure that activities included by a company in its CSR Policy are related to the areas or subjects specified in Schedule VII of the Act. d. The CSR Policy of the company shall specify that the surplus arising out of the CSR projects or programs or activities shall not form part of the business profit of a company.
Net Worth and Average Net Profit	**"Net worth"** *[As per Section 2(57)]* It means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, ➢ but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation. Explanation. —For the purposes of this section (i.e., section 135) "net profit" shall not include such sums as may be prescribed, and shall be calculated in accordance with the provisions of section 198. **Example:** The statutory auditors of a company were required to issue a certificate on the net worth of the company as per the requirement of the management as of 30 September 2018 computed as per the provision of section 2(57) of the Companies Act, 2013. The company had fair valued its property, plant and equipment in the current year which was mistakenly taken into retained earnings of the company in its books of accounts. Please advise whether this fair valuation would be covered in the net worth of the company as per the legal requirements. **Solution:** As per sec 2(57) of the Companies Act 2013, any reserves created out of revaluation of assets doesn't form part of net worth. The company fair valued its property, plant and equipment and took that to retained earnings. Even if the company has taken the fair valuation to the retained earnings in its books of accounts, the resultant credit in reserves (by whatever name called) would be in the category of 'reserves created out of revaluation of assets' which is specifically excluded in the definition of 'net worth' in section 2 (57) and hence should be excluded by the company. Further the auditors should also consider the matter related to accounting of this reserve separately at the time of audit of books of accounts of the company. **Calculation of Average Net profit:** "Average net profit" shall be calculated in accordance with the provisions of section 198 . "Net profit" shall not include the following: a) Any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and b) Any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act.
Disclosures in Board's Report	The Board's Report shall disclose- i) The composition of the CSR committee; ii) The contents of CSR policy; and

	iii) The reasons for not spending the amount of 2% in pursuance of its CSR Policy (in case the company fails to spend such amount).
Activities not amounting to CSR	As per Rule 4 and Rule 6 of the Companies (CSR Policy) Rules, 2014, following shall not amount to CSR activities for the purpose of sec. 135: a) The CSR projects or programs or activities undertaken outside India. b) The CSR projects or programs or activities that benefit only the employees of the company and their families. c) Companies my build CSR capacities of their own personnel as well as those of their implementing agencies through institutions with established track records of least 3 FYs but such expenditure including expenditure on administrative overheads, shall not exceed 5% of total CSR expenditure of the company in one FY. d) Contribution of any amount, directly or indirectly, to any political party u/s 182.
Manner of implementing CSR Policy	Rule 4 of the Companies (CSR Policy) Rules, 2014 makes the following provisions with respect to manner of implementation of CSR Policy: a) The CSR activities shall be undertaken by the company, as per its stated CSR Policy. b) The Board may decide to undertake its CSR activities approved by the CSR Committee, through- i) A company established u/s 8 of the Act or a registered trust or a registered society, established by the company, either single or along with any other company; or ii) A company established u/s 8 of the Act or a registered trust or a registered society, established by CG or SG or any entire established under an Act of Parliament or a State legislature; or iii) A company established u/s 8 of the Act or a registered trust or a registered society, other than those specified in (i) or (ii) above, if the following conditions are satisfied: ▪ Such company or trust or society has an established track record of 3 years in undertaking similar programs or projects. ▪ The company has specified the projects or programs to be undertaken, the modalities of utilisation of funds of such projects and programs and the monitoring and reporting mechanism. c) A company may also collaborate with other companies for undertaking projects or programs or CSR activities in such a manner that the CSR committees of respective companies are in a position to report separately on such projects or programs.
CSR Reporting	Rule 8 of the Company (CSR Policy) Rules, 2014, makes the following provisions with respect to CSR Reporting: a) The Board's Report pertaining to any FY commencing on or after the 1st day of April, 2014 shall include an annual report on CSR. b) In case of a foreign company, the balance sheet filed u/s 381 shall contain an Annexure regarding report on CSR.
Display of CSR Policy on the website	▪ The board shall place the CSR policy and its contents on the company's website, if any, in such manner as may be prescribed.
CSR Activities to be in accordance	The board shall ensure that activities included by a company in its CSR policy fall within the purview of the activities included in schedule VII.

with schedule VII	Schedule VII contains such activities which may be undertaken by the companies in pursuance of their CSR Policy. The activities specified under schedule VII are as under: i) Eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation including contribution to Swachh Bharat Kosh set up by CG for the promotion of sanitation and making available safe drinking water. ii) Promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled livelihood enhancement projects. iii) Promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups. iv) Ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality soil, air and water including contribution to the Clean Ganga Fund setup by CG for rejuvenation of river Ganga v) Protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts. vi) Measures for the benefit of armed forces veterans, war widows and their dependents. vii) Training to promote rural sports, nationally recognized sports, paralympic sports and Olympic sports. viii) Contribution to the Prime Minister's National Relief Fund or Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund (PM CARES Fund) or any other fund set up by CG for social-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes other backward classes, minorities and women. ix) Contribution to incubators funded by Central Government or State Government or any agency or Public Sector Undertaking of Central Government or State Government, and contributions to public funded Universities, Indian Institute of Technology (IITs), National Laboratories and Autonomous Bodies (established under the auspices of Indian Council of Agricultural Research (ICAR), Indian Council of Medical Research (ICMR), Council of Scientific and Industrial Research (CSIR), Department of Atomic Energy (DAE), Defence Research and Development Organisation (DRDO), Department of Science and Technology (DST), Ministry of Electronics and Information Technology) engaged in conducting research in science, technology, engineering and medicine aimed at promoting Sustainable Development Goals (SDGs). x) Rural development projects. xi) Slum area development xii) disaster management, including relief, rehabilitation and reconstruction activities. The MCA has provided many clarifications with regard to provisions of Corporate Social Responsibility under section 135 of the Companies Act, 2013 which are as under: a. It is further clarified that CSR activities should be undertaken by the companies in project/ programme mode. One-off events such as marathons/ awards/ charitable contribution/ advertisement/ sponsorships of TV programmes etc. would not be qualified as part of CSR expenditure. b. "Any financial year" referred under section 135(1) of the Act read with the Companies CSR

	Rule, 2014, implies 'any of the three preceding financial years. c. Expenditure incurred by Foreign Holding Company for CSR activities in India will qualify as CSR spend of the Indian subsidiary if, the CSR expenditures are routed through Indian subsidiaries and if the Indian subsidiary is required to do so as per section 135 of the Act. d. 'Registered Trust' would include Trusts registered under Income Tax Act 1956, for those States where registration of Trust is not mandatory. e. Contribution to Corpus of a Trust/ society/ section 8 companies etc. will qualify as CSR expenditure as long as ➢ the Trust/ society/ section 8 companies etc. is created exclusively for undertaking CSR activities or ➢ where the corpus is created exclusively for a purpose directly relatable to a subject covered in Schedule VII of the Act.
Penal Provisions	The Companies Act requires that— i) The Board's report shall disclose the composition of the Corporate Social Responsibility Committee as per subsection (3) of section 134; ii) If the company fails to spend such amount (i.e., at least two percent of the average net profit), the Board shall disclose and specify the reasons for not spending the amount in its report as per Clause (o) of sub-section (3) of section 134. As per section 134 of Companies Act, 2013 if the Company fails to disclose such information, it shall be punishable with fine, which shall not be less than fifty thousand rupees but which may extend to twenty-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 three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees or with both.
Example 1	ABC, a company with a turnover of INR 1000 Crores or more and having incurred a loss in any of the preceding three financial years, will be required to comply with CSR? **Answer** As per section 135(1) of the Act, if any one of the three criteria (whether net worth, or turnover, or net profit) gets satisfied than the company is mandatorily required to comply with the CSR provisions.
Example 2	XYZ Ltd is a listed company having turnover of INR 1200 crores during the financial year 2015-16. The CSR committee of the Board formulated and recommended a CSR project which was approved by the Board. Company finalised the project under its CSR initiatives which require funds @ 5 % of average net profit of the company for last three financial years. Will such excess expense be counted in subsequent financial years as a part of CSR expenditure? Advise. **Answer** In terms of Section 135(5) of the Companies Act, 2013, the Board of every company to which section 135 is applicable, shall ensure that the company spends, in every Financial year at least 2 per cent of average net profits of the company made during the three immediately preceding financial years, in pursuance of its CSR policy. There is no provision for carry forward of excess expenditure to the next year(s). The words used in the section are 'at least'. Therefore, any expenditure over 2% would be considered as voluntary higher spending.
Example 3	ADV Ltd is engaged in the business of construction and has various projects which are under execution in Delhi-NCR region. The company is also looking for new projects, particularly in Southern part of India based on an understanding that the margins are very high over there.

	During the year ended 31 March 2018, the company got covered within the requirements of CSR. Considering the nature of its business, company has a large employee base and it decided to spend CSR on some activity related to construction which would benefit its employees and would indirectly also help the business of the company. Please advise on this. **Solution:** As per the requirements of CSR, the projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act. Accordingly, in the given case, the activity planned by the company related to its business only and that too only for the benefit of its employees would not be considered as part of CSR requirements.

11. Right of Members to Copies of Audited Financial Statements [Sec 136]

Documents to be circulated	A copy of the following documents is required to be sent by the company: i) Financial statements ii) Consolidated financial statements, if any iii) Auditor's Report iv) All the documents which are required to be annexed or attached to FS. These documents are hereinafter referred to as 'FS and other documents'.
Persons entitled	The FS and other documents shall be sent to the following persons: a) Every member of the company. b) Every debenture trustee. c) Every person who is entitled to receive the notice of GM.
Time limit for circulation	1) The FS and other documents shall be sent at least 21 days before the date of AGM. If the copies of the documents are sent less than twenty-one days before the date of the meeting, they shall be deemed to have been duly sent if it is so agreed by members a) holding, if the company has a share capital, majority in number entitled to vote and who represent not less than ninety-five per cent of such part of the paid-up share capital of the company as gives a right to vote at the meeting; or b) having, if the company has no share capital, not less than ninety-five per cent. of the total voting power exercisable at the meeting: 2) In the case of a company licenced u/s 8, the FS and other documents shall be sent at least 14 days before the date of AGM. 3) In case of a listed company, it shall be sufficient compliance with provision of sec. 136, if- a) The copies of the FS and other documents are made available for inspection at its registered office during working hours for a period of 21 days before the date of AGM; and b) A statement containing the salient features of such documents in form AOC – 3 is sent unless the shareholders ask for full FS and other documents.
Manner of Circulation of FS and other documents in certain cases	In case of a) All listed companies; and b) Public companies having net worth of more than INR 1 crore and turnover of more than INR 10 crore, the FS and other documents shall be circulated

	i) By electronic mode in the following 2 cases; a) Where a member holds share in dematerialized form and his email ID is registered with the depository for communication purposes. b) Where a member does not hold shares in dematerialized form, but he has positively consented in writing for receiving such documents by electronic mode. ii) By dispatch of physical copies through any recognised mode of delivery as specified u/s 20, in all other cases
Display at the website	A listed company shall also place its FS and other documents on its website, which is maintained by or on behalf of the company.
Additional duties for a company having a subsidiary	Every company having a subsidiary or subsidiaries shall: a) Place separate audited FS and other documents in respect of each of its subsidiary on its website, if any; b) Provide a copy of separate audited FS and other documents in respect of each of its subsidiary, to any member of the company who ask for it.
Inspection	Every company shall allow every member and debenture trustee to inspect the FS and other documents at its registered office during business hours.
Example	Reliance Industries Limited, a company incorporated under the Companies Act, 2013, has its shares listed on a recognized Stock Exchange in India. One of the subsidiaries of Reliance Industries Limited is a foreign company incorporated outside India. In the annual general meeting of the company, Reliance Industries Limited has placed its audited financial statement including consolidated financial statement on its website. Reliance Industries Limited has also placed on its website separate audited accounts of all its subsidiary located in India except one subsidiary, which is a foreign company and located outside India on the grounds that such foreign company is not required to get its financial statement audited under the company law of its incorporation. You are required to examine whether Reliance Industries Limited has complied with the provisions of section 136? **Answer:** No, Reliance Industries Limited has not complied with the provisions of section 136 because Reliance Industries Limited is also required to place unaudited financial statement of its foreign subsidiary on its website even if such foreign subsidiary is not required to get its financial statement audited as per the provisions of section 136.

12. Filing of Financial Statements and Other Documents with the Registrar [Sec 137]

Where FS are adopted at the AGM	**Documents to be filed**	i) FS ii) CFS, if any iii) The accounts of its subsidiary or subsidiaries which have been incorporated outside India and which have not established any place of business in India iv) All the documents which are required to be annexed or attached to FS. These documents are hereinafter referred to as 'FS and other documents'.
	Time limit for filing	The FS and other documents shall be field with the Registrar within 30 days of the date of AGM.

<table>
<tr><td rowspan="3">When FS are not adopted at the AGM</td><td>Filing of unadopted documents</td><td>Where the FS are not adopted at the AGM or adjourned AGM,
➢ such unadopted FS and other documents shall be filed
➢ with the registrar within 30 days of the date of AGM.</td></tr>
<tr><td>Unadopted documents to be provisional</td><td>The registrar shall take the unadopted FS and other documents in his records as provisional till the FS are filed with him after their adoption in the adjourned AGM for that purpose.</td></tr>
<tr><td>Filing of adopted documents</td><td>The FS and other documents adopted in the adjourned AGM shall be filed with the register within 30 days of the date of such adjourned AGM.</td></tr>
<tr><td rowspan="2">Where AGM is not held</td><td>Filing of documents</td><td>i) The FS and other documents
ii) Statement of facts and reasons for not holding the AGM.</td></tr>
<tr><td>Time limit for filing</td><td>The FS and other documents shall be filed with the Registrar within 30 days of last date upto which the AGM should have been held.</td></tr>
<tr><td>Filing in case of One Person Company</td><td colspan="2">One Person Company shall file a copy of the FS duly adopted by its member, along with all the documents which are required to be annexed or attached to such FS,
➢ within 180 days from the closure of the FY.</td></tr>
<tr><td>Company having subsidiaries</td><td colspan="2">A company shall, along with its financial statements to be filed with the Registrar,
➢ attach the accounts of its subsidiary/subsidiaries incorporated outside India and
➢ which have not established their place of business in India.
Further, in case of a subsidiary incorporated outside India (referred as ‘foreign company’)
➢ which is not required to get its accounts audited as per laws of the country of its incorporation; and
➢ which does not get such accounts audited,
➢ the holding or parent Indian may place or file such unaudited accounts
➢ along with the declaration to this effect
➢ to comply with requirements of section 136(1) and 137(1) as applicable.
If FS of foreign subsidiary is in language other than English, translated copy of FS in English shall be filed.
Further, the format of accounts of foreign subsidiaries should be, as far as possible, in accordance with requirements under the Companies Act, 2013.
In case this is not possible, a statement indicating the reasons for deviation may be placed/ filed along with such accounts.
Example
Vandana Ltd, based out of India, has many subsidiaries in India and outside India. It also had associates and joint ventures. For the purpose of finalization of the consolidated financial statements of the company for the year ended 31 March 2019, the company’s management requested its foreign subsidiary, based out of Italy, to provide its standalone financial statements. The Italian subsidiary company prepares its financial statements in the local language of the country and the same is provided to the Indian parent unaudited as the audit is not required by the Italian subsidiary company. Please advise how should the Indian parent deal with this financial statement.
Solution:
Vandana Ltd would have to get the standalone financial statements of Italian subsidiary company translated in Indian and also get those aligned as per the its accounting policies for</td></tr>
</table>

	the purpose of consolidation. Further as per the requirements of section 137(1) of the Companies Act 2013, Vandana Ltd would need to file such unaudited financial statement of Italian subsidiary company along with a declaration to this effect along with a translated copy of the financial statement in English. Further the format of accounts of Italian subsidiary company should be, as far as possible, in accordance with requirements under the Companies Act, 2013. In case this is not possible, a statement indicating the reasons for deviation may be placed/ filed along with such accounts.
Forms and fees [Rule 12 of the Companies (Accounts) Rules, 2014]	a) Every company shall file the FS with the Registrar together with Form AOC–4 and the CFS, if any, with Form AOC-4CFS. b) The class of companies as may be notified by CG from time to time, shall mandatorily file their FS in Extensible Business Reporting Language (XBRL) format. CG may also specify the manner of such filing under such notification for such class of companies. The term "Extensible Business Reporting Language" means a standardised language for communication in electronic form to express, report or file financial information by companies. As per rule 3 of the Companies (Filing of Documents and Forms in Extensible Business Reporting given in Annexure II, namely): i) All companies listed with any Stock Exchange (s) in India and their Indian subsidiaries ii) All companies having paid up capital of INR 5 crore or above iii) All companies having turnover of INR 100 crore or above iv) All companies which were hitherto covered under the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011. However, the companies in banking, insurance, power sector, non-banking financial companies and housing finance companies need not file FS in XBRL. c) The fees or additional fees payable shall be as specified in the companies (Registration Officers and Fees) Rules, 2014.
Example 1	The Annual General Meeting of R Ltd. for laying the Annual Accounts thereat for the year ended 31st March, 2018 was not held. What remedies is available with the company regarding compliance of the provisions of section 137 of the Companies Act, 2013 for filing of copies of financial statements with the Registrar of Companies? **Answer** In the present case, although Annual General Meeting was not held, it ought to be held by 30th September, 2018 under section 96 of the Companies Act, 2013. Therefore, under the provisions of section 137(2), the financial statements along with the documents required to be attached under this Act, duly signed along with the statement of facts and reasons for not holding the annual general meeting shall be filed with the Registrar within thirty days of the last date before which the annual general meeting should have been held i.e. by 30th October 2018 along with such fees or additional fees as may be prescribed.
Example 2	Will it make any difference in case the Annual Accounts were duly laid before the Annual General Meeting held on 27th September, 2018 but the same were not adopted by the shareholders? **Answer** Since the Annual General Meeting has been held in time on 27th September, 2018, the unadopted financial statements along with the required documents under sub-section (1) of section 137 shall be filed with the Registrar within thirty days of the date of annual general meeting and the Registrar shall take them in his records as provisional till the financial

	statements are filed with him after its adoption in the adjourned annual general meeting for that purpose.
Example 3	ABC Ltd is an unlisted public company engaged in pharma sector and has paid up capital of rupees 10 crores and achieved turnover of rupees 200 crores during financial year 2017-18. Is it necessary for ABC Ltd to file its financial statement in XBRL mode? **Answer** The following class of companies shall file their financial statement in XBRL (extensible Business Reporting Language) mode and by using the XBRL taxonomy: a) all companies listed with any stock exchange in India and their Indian subsidiaries; or b) all companies having paid up capital of rupees 5 crores or above; c) all companies having turnover of rupees 100 crores or above; or d) all companies which were covered under the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011. However, Banking Companies, Insurance Companies, Power Companies and Non- Banking Financial Companies (NBFCs) and housing finance companies need not file financial statements under this rule. ABC Ltd is required to file its financial statement in XBRL mode.

Penalty for Contravention	**Person Liable**	**Punishment for contravention of section 137**
	Company	**Penalty** of 1,000 for every day during which the failure continues.
	Officers— Managing Director and the Chief Financial Officer of the company, if any. In their absence, any other director who is charged by the Board with the responsibility In its absence, all the directors of company.	**Penalty** of one lakh rupees and in case of continuing failure, with a further penalty of one hundred rupees for each day after the first during which such failure continues, subject to a maximum of five lakh rupees.

13. Internal Audit [Sec 138]

Applicability of Sec. 138	Sec. 138 shall apply to following class of companies: **a)** Every listed company. **b)** Every unlisted public company having- i) outstanding deposits of INR 25 crore or more at any point of time during the preceding FY; or ii) paid up share capital of INR 50 crore or more during the preceding FY; or iii) outstanding loans or borrowings from banks or public financial institution exceeding INR 100 crore or more at any point of time during the preceding FY; or iv) turnover of INR 200 crore or more during the preceding FY. **c)** Every private company having- i) outstanding loans or borrowings from banks or public financial institutions exceeding INR 100 crore or more at any point of time during the preceding FY; or ii) turnover of INR 200 crore or more during the preceding FY

Legal requirements u/s 138	a) Every company to which sec. 138 is applicable, shall appoint an internal auditor. b) The internal auditor shall conduct internal audit of the functions and activities of company. c) The internal auditor shall be- i) A chartered accountant; or ii) A cost accountant; or iii) Such other professional as may be decided by the Board. d) The internal auditor may or may not be employee of the Company. e) The internal auditor may be an individual or a partnership firm or a body corporate. f) A 'Chartered Accounted' may be appointed as an internal auditor whether or not he is engaged in practice. g) A 'Cost Accountant' may be appointed as an internal auditor whether or not he is engaged in practice.
Manner and interval of internal audit	a) CG may, by rules, prescribed the manner and the intervals in which the internal audit shall be conducted and reported to the Board. b) 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.
Requirements for exiting companies	If an existing company satisfies any of the criteria laid down under Rule 13 (i.e. it falls under the prescribed class (es) of companies for the purpose of Sec. 138) it shall, within 6 months, comply with the requirements of Sec. 138 and Rule 13.
Example:	Perfect Ltd is a listed company. The company is in the business of manufacturing of steel and had its head office at Karnataka. The company's operations are spread out across India. The company appointed a firm of Chartered Accountants, N & Co LLP, as its internal auditors for the year ended 31 March 2019. However, for the financial year 2019-20, the company is planning to have an in-house internal audit system commensurate with its size and operations. If the company does that then it is planning not to continue with N & Co LLP as its internal auditors. Please advise. a. The company being listed needs to have a firm of CA as its internal auditors and hence the company needs to continue with N & Co LLP or appoint some other firm. b. The company being listed needs to have a firm of CA as its internal auditors and hence the company needs to continue with N & Co LLP or may appoint some other consultant which may not be a firm. c. The company being listed should not change its internal audit process within a year and hence should continue with N & Co LLP. d. If the internal audit function of the company is fine as per its size and operations then it may decide not to continue with N & Co LLP. **Solution** – Option d

ARISE AWAKE AND STOP NOT TILL YOUR GOAL IS ACHIEVED

-Swami Vivekanand

About CA Kishan Kumar

- ★ Kishan Kumar is an **Associate member** of The Institute of Chartered Accountants of India.
- ★ He is a **throughout Rankholder** in CA examinations.
- ★ He himself scored **Exemption in EIS-SM** in his CA Inter Exam..
- ★ He has been **awarded by Nitish Kumar, Hon'ble Chief Minister** of Bihar for his excellence in the field of education.
- ★ Internationally renowned **University of South Wales** has also felicitated him for his aptitude and achievements during his academic life.
- ★ Kishan has worked with **Ernst & Young and PwC (Big 4 Firms)** and uses his practical corporate experience to make the subject more interesting and engaging.
- ★ His students have secured **marks as high as 85** and hundreds have scored exemptions.
- ★ He is committed to make meaningful contribution to the life of promising CA aspirants.

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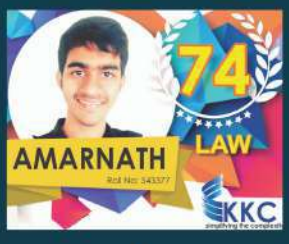

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CHAPTER 10
AUDIT AND AUDITORS

Be stronger than your excuses.

1. INTRODUCTION

Large business corporations are managed by the directors who represent the members who are the real owners of the company. In the absence of any check the directors may mismanage the finances of the organisation.

Thus, members appoint auditor to look into the true and fair view of the financial affairs of the company. These auditors are independent from the management of the company and hence can express an un- biased opinion

2. APPOINTMENT OF AUDITORS AT AGM (FIRST AGM AND SUBSEQUENT AGMS) [SEC 139(1)]

Applicability	The provisions of Sec. 139(1) are applicable to all companies, expect- a) Government companies; b) any other company owned or controlled, directly or indirectly, by- i) CG; or ii) one or more SG; or iii) Partly by CG and partly by one or more SG.
Appointment and re-appointment of auditors till sixth AGM	a) Every company shall appoint an individual or a firm as an auditor of the company at the first annual general meeting (AGM). **Example:** Rashail Techlabs Private Limited incorporated during the financial year 2019-20. First AGM of the company held on 30.09.2020. The company appointed M/s. Rams & Associates, Chartered Accountant firm for the period of 5 Years as a subsequent statutory auditor. b) The auditor so appointed shall hold office from the conclusion of 1st AGM till the conclusion of 6th AGM. c) After the 1st AGM, when any appointment of auditors is made at any AGM, the auditors so appointed shall hold office till the conclusion of 6th AGM, with the AGM wherein such appointment has been made being counted as the first AGM [Sec. 139(1) read with Rule 3(7)].
Manner and procedure of selection of auditors (Rule 3)	The manner and procedure of selection of auditors by the members of the company at any AGM shall be such as may be prescribed. Rule 3 of the companies (Audit and Auditors) Rules, 2014 prescribes the following procedure: 1) The qualifications and experience of individual or the firm proposed to be appointed as auditors shall be considered by- a) The Board; or

	b) The Audit committee in case the company is required to constitute an Audit committee. 2) While considering the appointment, Board/ Audit committee shall have due regard to: a) Any order of professional misconduct passed against the proposed auditor; and b) Any proceedings of professional misconduct pending against the proposal auditor. 3) The Board / Audit Committee may call for such other information from the proposed auditor as it may deem fit. 4) In case the company is not required to constitute the Audit Committee, the Board shall consider and recommend an individual or a firm as auditor to the members in the AGM for appointment. 5) In case the company is required to constitute the Audit Committee, following procedure shall be adopted: a) The Audit committee shall recommend the name of an individual or a firm as auditor to the Board for consideration. b) If the Board agrees with the recommendation of the Audit Committee, it shall further recommend such individual or such firm as auditor to the members in the AGM for appointment. c) If the Board disagrees with the recommendation of the Audit Committee, it shall refer back the recommendation to the audit committee for reconsideration citing reasons for such disagreement. d) If the Audit Committee, after considering the reasons given by the Board, decides not to reconsider its original recommendation and the Board continues to disagree with the recommendation of the audit committee, the Board shall- i) Record reasons for its disagreement with the committee; ii) Send its own recommendation for consideration of the members in the AGM. e) If the audit committee, after considering the reasons given by the Board, decides not to reconsider its original recommendation, and the Board agrees with the recommendation of the audit committee, the Board shall recommend the name of the individual or the Firm recommended by the audit committee to the members in the AGM for appointment. **Example:** Audit Committee recommended KPM & Associates, Chartered Accountants firm for appointment as statutory auditor to the board of Surya Solar Limited. However, board of the company disagreed with the recommendation of the audit committee. In such condition, board shall refer back the recommendation to the committee for reconsideration citing reasons for such disagreement.
Companies that require to constitute an audit committee [Sec 177]	The Board of directors of a) every listed companies and the b) following classes of companies shall constitute an Audit Committee- 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.

	as existing on the date of last audited financial statements

3. Reappointment of Retiring Auditor [Sec. 139(9) & 139(10)]

Reappointment of retiring auditor	A retiring auditor may be appointment at an AGM if- a) He is not disqualified for re- appointment; b) He has not given to the company a notice in writing of his unwillingness to be re-appointed; and c) A special resolution has not been passed at the AGM- i) Appointing some other auditor; or ii) Providing expressly that he shall not be re-appointed.
No auditor is appointed or reappointed at AGM – consequences	Where at any AGM, ➢ No auditor is appointed or re-appointed, ➢ The existing auditor shall continue to be the auditor of the company.

4. Rotation of Auditors [Sec 139(2) and 139(4)]

Applicability of concept of rotation of auditors [sec. 139(2)]	**a)** The concept of rotation of auditors is applicable to- i) listed company; and ii) all companies belonging to such class or classes of companies as may be prescribed. **b)** Following classes of companies have been prescribed for the purpose of rotation of auditors [Rule 5 of the Companies (Audit and Auditors) Rules, 2014]: i) All unlisted public companies having paid up share capital of INR 10 cr. or more; ii) All private limited companies having paid up share capital of INR 50 cr. or more; iii) All company having paid up share capital below the limits mentioned in (a) and (b) above, but having public borrowing from financial institutions, banks or public deposits of INR 50 cr. or above. **Note:** The concept of rotation of auditors shall not apply to One Person Companies or small companies.	
Term of Auditor - Cooling off period	***In case, the auditor is an individual***	i) No individual shall be appointed or reappointed as auditor for more than 1 term of 5 consecutive years. ii) An individual auditor, who has completed his term of 5 consecutive years, shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of his term.
	In case, the auditor is a firm	i) No audit firm shall be appointed or reappointed as auditor for more than 2 terms of 5 consecutive years. ii) An audit firm which has completed its 2 terms of 5 consecutive years, shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of such terms.
Example 1	XYZ Ltd. which is a listed company appoints Mr. Raghav as an auditor in its AGM dated 29th September, 2018. Mr. Raghav will hold office of Auditor from the conclusion of this meeting	

	upto conclusion of sixth AGM i.e., AGM to be held in the year 2023. Now as per sub-section (2), Mr. Raghav shall not be re-appointed as Auditor in XYZ Ltd. for further term of five years i.e., he cannot be appointed as Auditor upto year 2028.
Example 2	XYZ Ltd. which is a listed company appoints M/s Raghav & Associates as an audit firm in its AGM dated 29th September, 2018. M/s Raghav & Associates will hold office from the conclusion of this meeting upto conclusion of sixth AGM to be held in the year 2023. Now as per sub-section (2), M/s Raghav & Associates can be appointed or re-appointed as auditor for one more term of five years i.e., upto year 2028. It shall not be re-appointed as Audit firm in XYZ Ltd. for further term of five years i.e., upto year 2033.
Restriction on other audit firm (s) having common partner (s)	▪ An audit firm having one or more common partner to the other audit firm, whose tenure has expired, shall not be appointed as the auditor of the same company for a period of 5 years. ▪ In other words, if two or more audit firms have common partner and one of these firms has completed its 2 terms of 5 consecutive years, none of such audit firms shall be eligible for reappointment as auditor in the same company for 5 years.
Example 3	M/s Krishna & Associates is an audit firm having 2 partners namely Mr. Krishna and Mr. Shyam. Mr. Shyam is also a partner of another audit firm named M/s Kukreja & Associates. M/s Krishna & Associates was appointed as the auditors in the company Golden Smith Ltd. for two consecutive periods i.e., from year 2018 to year 2028. Now, if Golden Smith Ltd. wants to appoint M/s Kukreja & Associates as its audit firm, it cannot do so because Mr. Shyam was the common partner between both the Audit firms. This prohibition is only for 5 years i.e., upto year 2033. After 5 years Golden Smith Ltd. may appoint M/s Kukreja & Associates as its auditors.
Time period for compliance for existing companies	▪ Every company existing on the commencement of this Act (viz. 1.4.2014), ➢ which is required to comply with the provisions relating to rotation of auditors, ➢ shall comply with these requirements within a period ➢ which shall not be later than the date of the first AGM of the company held, ➢ within the period specified u/s 96, ➢ after 3 years from the date of commencement of this Act. ▪ Simply speaking, the existing companies are required to comply with the provisions relating to rotation of auditors in the AGM to be held for the financial year 2016-17 and such AGM must be held within the time limit specified u/s 96 viz. on or before 30.09.2017.
Right of removal or resignation not affected	a) The right of the company to remove an auditor before expiry of one/two term (s) of 5 consecutive years shall not be affected due to any provision contained in sec. 139(2). b) The right of the auditor to resign from the office of auditor before expiry of one/two term (s) of 5 consecutive years shall not be affected due to any provision contained u/s 139 (2).
Rotation of Auditor - may be imposed by members	Members of a company may resolve to provide that- i) In the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or ii) The audit shall be conducted by more than one auditor.
Rules for rotation of auditors	CG may, by rules, prescribe the manner of rotation of auditors. ***Manner of rotation of auditors by Companies on expiry of their term (Rule 6)*** 1) In case the company is required to constitute an Audit Committee, the procedure shall be as follows:

	a) 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. b) The Board shall consider the recommendation of the audit committee. c) The Board shall make its own recommendation for appointment of the next auditor by the members in the AGM. 2) In case the company is not required to constitute an audit committee, the procedure shall be as follows: a) The Board shall itself consider the matter of rotation of auditors. b) The Board shall make its own recommendation for appointment of the next auditor by the members in the AGM. 3) 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 5 consecutive years or 10 consecutive years, as the case may be. 4) 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. 'Same network' includes the firms operating or functioning under the same brand name, trade name or common control. 5) A break in the term for a continuous period of years shall be considered as fulfilling the requirement of rotation. 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 5 years.

Illustration explaining rotation in case of Individual Auditor

Column I	Column II	Column III
Number of consecutive years for which an individual auditor has been functioning as auditors in the same company [in the first AGM held after the commencement of provisions of Sec. 139(2)]	Maximum number of consecutive years for which he may be appointed in the same company [including transitional period]	Aggregate period which the auditor would complete in the same company in view of column I and II
5 years (or more than 5 years)	3 years	8 years or more
4 years	3 years	7 years
3 years	3 years	6 years
2 years	3 years	5 years
1 year	4 years	5 years

Note 1: Individual auditors shall include other individuals or firms whose name or trade mark or brand is used by such individual, if any.

Note 2: Consecutive years shall mean all the preceding FYs for which the individual auditor has been the auditor until there has been a break by five years or more.

Illustration explaining rotation in case of Audit Firm

Column I	Column II	Column III

Number of consecutive years for which an individual auditor has been functioning as auditor in the same company [in the first AGM held after the commencement of provisions of Sec. 139(2)]	Maximum number of consecutive years for which he may be appointed in the same company [including transitional period]	Aggregate period which the auditor would complete in the same company in view of column I and II
10 years (or more than 10 years)	3 years	13 years or more
9 years	3 years	12 years
8 years	3 years	11 years
7 years	3 years	10 years
6 years	4 years	10 years
5 years	5 years	10 years
4 years	6 years	10 years
3 years	7 years	10 years
2 years	8 years	10 years
1 year	9 years	10 years

Note 1: Audit firm shall include other firms whose name or trade mark or brand is used by the firm or any of its partners.

Note 2: Consecutive years shall mean all the preceding FYs for which the firm has been the auditor until there has been a break by five years or more.

Note 2: Where a company has appointed two or more individuals or firms or a combination thereof as joint auditors, the company may follow the rotation of auditors in such a manner that both or all of the joint auditors, as the case may be, do not complete their term in the same year.

5. Appointment of First Auditor [Sec. 139 (6) and 139 (7)]

Manner of appointment of first auditor	***Case 1 [Sec.139 (7):*** **The company is a Government Company or any other company owned or controlled, directly or indirectly, by CG, or by one or more SG, or partly by CG and partly by one or more SG:**	***Case 2*** **[Sec. 139(6): The company is any other company**
	i) the first auditor shall be appointed by CAG within 60 days of registration of the company. ii) In case CAG does not appoint the first auditor within the said period of 60 days, Board shall appoint the first auditor within next 30 days.	i) The first auditor shall be appointed by the Board of directors within 30 days of registration of the company.
	iii) In case of failure of the Board to appoint the first auditor within the period of 30 days, the Board shall inform the members of the company who shall appoint the first auditor within 60 days at an EGM.	ii) If the Board fails to appoint the first auditor within 30 days of registration of the company, the Board shall inform the members of the company who shall appoint the first auditor within 90 days at an EGM.
Tenure of first auditor	▪ The first auditor shall hold office till the conclusion of first AGM [sec. 139(6) and 139 (7)].	
Example	Unicorn Steel Private Limited is incorporated as on 02.06.2020, board of directors of the company held board meeting as on 15.06.2020 to appoint Jain Ajmera & Associates as a first auditor of the company for a term of 5 years. As per section 139(6) of the companies act, 2013, the board shall appoint first director within 30 days from the date of registration of the company. State the validity of the aforesaid situation.	

	a) Invalid b) Valid c) Valid after approval of shareholder in General Meeting d) Valid only after approval of Central Government **Answer:** The given situation is Invalid i.e., option (a).
Example	Managing Director of PQR Ltd. himself wants to appoint Shri Ganpati, a practicing Chartered Accountant, as first auditor of the company. Comment on the proposed action of the Managing Director. **Answer** **Provisions and Explanation:** Section 139(6) of the Companies Act, 2013 lays down that "the first auditor or auditors of a company shall be appointed by the Board of directors within 30 days from the date of registration of the company". In the instant case, the appointment of Shri Ganapati, a practicing Chartered Accountant as first auditors by the Managing Director of PQR Ltd by himself is in violation of Section 139(6) of the Companies Act, 2013, which authorizes the Board of Directors to appoint the first auditor of the company. **Conclusion:** In view of the above, the Managing Director of PQR Ltd should be advised not to appoint the first auditor of the company.

6. Appointment of Subsequent Auditor in case of Government Company [Sec 139(5)]

Applicability of sec. 139(5)	a) Government companies b) Any other company owned or controlled, directly or indirectly, by- i) CG; or ii) One or more SG; or iii) Partly by CG and partly by one or more SG.
Appointment or reappointment of auditor	In case of aforementioned companies, ➢ CAG shall, in respect of a FY, appoint the auditor, ➢ Within 180 days from the commencement of the FY.
Tenure	▪ The auditor shall hold office till the conclusion of the AGM.

7. Filling of Casual Vacancy in the Office of Auditors

Manners of filling casual vacancy	***Case I***	***Case II***
	The casual vacancy arises in a company whose accounts are subject to audit by an auditor appointed by CAG	**The casual vacancy arises in any other company.**
	i) Such casual vacancy shall be filled within 30 days by CAG. ii) In case CAG does not fill the casual vacancy within 30 days, the Board shall	i) Such casual vacancy shall be filled within 30 days by the Board. ii) In case the casual vacancy arose due to the resignation of auditor, it shall be

	fill the casual vacancy within next 30 days.	filled within 30 days by the Board of directors and the appointment made by the Board shall be approved in a GM convened within 3 months of the recommendation of the Board.
Tenure of office	Any auditor appointed to fill a casual vacancy shall hold office till the conclusion of next AGM.	
Meaning of casual vacancy	a) The term 'casual vacancy' has not been defined under the Companies Act 2013. It generally means a vacancy caused by the auditor ceasing to act as such after accepting a valid appointment, e.g., due to death, disqualification, resignation, etc. b) It must be noted that a vacancy created because of resignation of an auditor falls within the meaning of casual vacancy as explained above. However, such a 'casual vacancy' shall be filled up by the Board and shall also be approved by the members in general meeting.	
Example	Prakash Carriers Limited appointed Mr. Raman as its auditor in the Annual General Meeting held on 30th September, 2018. Initially, he accepted the appointment. But he resigned from his office on 31st October, 2018 for personal reasons. The Board of directors seeks advice for filling up the vacancy by appointment of Mr. Albert as auditor. In the present case, as the auditor has resigned, the casual vacancy so created can be filled up by the Board appointing Mr. Albert. However, the appointment of Mr. Albert must be approved by the company by passing of an ordinary resolution at a general meeting of the company which must be convened by the Board within 3 months of the recommendation of the Board. Mr. Albert will be entitled to hold office till the conclusion of the next Annual General Meeting.	

8. Certification and Consent by Auditor, and Notice of Appointment by Company [Sec. 139]

Certificate and consent to be given by the Auditor	Before any appointment of auditor is made, the auditor shall furnish to the company- a) his written consent for such appointment; and b) a certificate that- i) the appointment, if made, shall be in accordance with the conditions as may be prescribed; and ii) the auditor satisfies the criteria provided in Sec. 141. ***Conditions prescribed for appointment and notice to registrar (Rule 4)*** The auditor proposed to be appointed shall submit a certificate that- a) the individual or the firm 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; b) the proposed appointment is as per the term provided under the Act; c) the proposed appointment is within the limits laid down under the Act; d) the list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect of professional matters of conduct, as disclosed in the certificate is true and correct.
Notice of appointment to be given by the company	The company shall- a) inform the auditor concerned of his or his or its appointment; and

	b) file a notice of such appointment with the Registrar in Form No. ADT-1 within 15 days of the meeting in which the auditor is appointed.
	As per NFRA Rules, everybody corporate, other than a company as defined in section 2(20) of the Act, formed in India and governed under NFRA Rules shall, ➢ within 15 days of appointment of an auditor, ➢ inform the NFRA in Form NFRA-1, ➢ the particulars of the auditor appointed by such body corporate.

9. Miscellaneous Provision W.R.T Appointment of Auditors [Section 139]

'Firm' to include limited liability partnership	For the purpose of this chapter (viz. 'Audit and Auditors', consisting of Sec. 139 to 148), ➢ the word 'firm' shall include a limited liability partnership incorporated under the limited liability partnership Act, 2008.
Meaning of appointment	For the purpose of this chapter (viz. 'Audit and Auditors', consisting of Sec. 139 to 148), ➢ 'Appointment' includes reappointment.
Recommendation of the audit committee to be considered [sec. 139(11)]	▪ Where a company is required to constitute an audit committee u/s 177, ➢ all appointments, including the filling of a casual vacancy of an auditor u/s 139(8) ➢ shall be made after taking into account the recommendations of the audit committee.

10. Removal of Auditor Before Expiry of His Term [Section 140(1)]

Resolution	Such removal requires a special resolution.
Approval	Previous approval of CG must be obtained in the manner prescribed. *(Powers delegated to Regional Director)* **Procedure for Removal of Auditor** i) A Special Notice is received (from Director/Member etc.) for Removal of auditor. ii) A board meeting will be held to decide the proposal for removing auditor and then authorising the filing of application to CG. iii) An application shall be made to CG in form ADT-2 within 30 days of passing the Board resolution. The application shall be accompanied with the prescribed fees. iv) After approval from CG, company shall hold the general meeting within 60 days of receipt of approval of CG. v) Special Notice shall be sent for AGM. vi) Auditor shall be given a reasonable opportunity of being heard. vii) Auditor shall be removed by passing the special resolution.
Example	Mr. Suresh, a Chartered Accountant, was appointed by the Board of Directors of AB Limited as the First Auditor. The company in General Meeting removed Mr. Suresh without seeking the approval of the Central Government and appointed Mr. Gupta as Auditor in his place. In this case, the first auditors appointed by Board of Directors can be removed in accordance with the provision of Section 140(1) of the Companies Act, 2013. Hence, the removal of the first auditor appointed by the Board without seeking approval of the Central Government is invalid. The company contravened the provision of the Act.

11. Resignation by Auditor [Sec. 140(2) and 140(3)]

Duty of auditor	When an auditor resigns, he is required to file a statement in the prescribed form, viz. ADT-3.
Contents of the statement	The statement shall indicate the reasons and other fact as may be relevant with regard to his resignation.
Filing with whom?	The statement shall be filed with- ▪ the company; ▪ the Registrar; and ▪ CAG, in the case of a Government company or a company owned or controlled by CG or SG (s) or party by CG and partly by SG (s).
Time limit of filing	The statement shall be filed within 30 days from the date of resignation.
Fine for non-filing	▪ **Penalty** of fifty thousand rupees or an amount equal to the remuneration of the auditor, whichever is less ▪ In case of continuing failure, with further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of five lakh rupees.

12. Appointing Auditor other than the Retiring Auditor [Sec. 140(4)]

Requirement of special notice	If the retiring auditor has not completed a consecutive tenure of 5 years or, as the case may be, 10 years, as provided under sub-section (2) of section 139, ➢ special notice shall be required for a resolution at an annual general meeting a) appointing as auditor a person other than the retiring auditor; or b) providing expressly that the retiring auditor shall not be reappointed.
Copy to be sent to the retiring auditor	On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.
Right of auditor to make a representation and to get it circulated	i) The retiring auditor is entitled to make a representation. The representation (not exceeding a reasonable length) shall be in writing and shall be sent to the company. ii) He may request the company to circulate the representation to the members of the company. iii) In the AGM, the retiring shall have a right to make an oral representation.
Duties of the company w.r.t representation	i) The company shall state the fact that the retiring auditor has made a representation in any notice of the resolution that is given to the members of the company. ii) The company shall send a copy of the representation to every member of the company to whom notice of the meeting is sent (unless the representation is received by the company too late). iii) If a copy of the representation is not sent because it was received too late or because of the company's default, then- a) The auditor may require that the representation shall be read out at the meeting; b) A copy of the representation shall be filed with the registrar.
Intervention by tribunal	i) The copies of the representation

	➢ need not be sent to the members and ➢ the representation made by the auditor need not be read out at the meeting ➢ if the Tribunal is satisfied that ➢ the right of making representation is being abused by the auditor. ii) The application to the Tribunal may be made either by the company or by any other person who claims to be aggrieved.
Non-applicability	The provisions of sec. 140(4) (viz. the provisions relating to special notice) shall not apply where the retiring auditor has completed his tenure of 5 consecutive years / 10 consecutive years, as provided u/s 139(2).

13. Auditor Acts in Fraudulent Manner or Abetted or Colluded in any Fraud - Power of the Tribunal to Order Change of Auditor [Sec. 140(5)]

Application to the Tribunal, and reason for Tribunal's order	i) The application to the Tribunal may be made by CG or by any other person concerned. The Tribunal may also act suo motu. ii) If the tribunal is satisfied that the auditor has, whether directly or indirectly, acted in fraudulent manner or abetted or colluded in any fraud, it may, by order direct the company to change its auditors. iii) The powers of the tribunal u/s 140(5) shall be in addition to any action that may be taken under the provision of this Act or any other law for the time being in force.
Appointment of auditor by CG on an order made by the tribunal	▪ If the application is made by CG and the tribunal is satisfied that any change of the auditor is required. it shall within 15 days of receipt of such application, make an order that such auditor shall not function as an auditor and CG may appoint another auditor in his place.
Auditor to be disqualified for 5 years	i) An auditor against whom an order has been passed by the tribunal u/s 140(5) a) shall not be eligible to be appointed as an auditor of any company for a period of 5 years; and b) shall be liable for Action u/s 447. ii) The disqualification, as stated above, and the liability u/s 447 shall apply irrespective of the fact as to whether the auditor is an individual or a firm. iii) In the case of a firm, the liability shall be of the firm and of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud. **Note:** For the purposes this chapter, the word auditor includes a firm of auditors.
Example	FLP Ltd, engaged in the business of real estate and energy, defaulted on its borrowings which amounted to thousands of crores. During the year ended 31 March 2019, a fraud was uncovered in respect of various transactions of the company and it was observed by the Central Govt that the auditors of the company were involved in such fraud. Please suggest what can be the course of action in this case. **Solution** The Central Government may apply to the Tribunal in respect of such matter highlighting that the auditors miserably failed to fulfil their duties as auditors of the company. If the Tribunal is satisfied that the auditors were involved in the fraud with the company, the Tribunal may direct the company to change its auditors and those auditors shall not be eligible to be appointed as auditor of any company for 5 years and also liable for action under section 447 of the Companies Act 2013.

14. Eligibility, Qualification and Disqualifications of Auditors [Sec. 141]

<table>
<tr><td rowspan="2">Eligibility for appointment as an auditor</td><td>Eligibility for an individual</td><td>An individual shall be eligible for appointment as an auditor of a company only if he is a Chartered Accountant.</td></tr>
<tr><td>Eligibility for a firm</td><td>A firm shall be eligible for appointment as an auditor of a company only if majority of its partners practicing in India are qualified for appointment.

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.</td></tr>
<tr><td>Disqualifications of auditor [sec. 141(3)]</td><td colspan="2">Following persons shall not be eligible for appointment as an auditor of a company.

a) A body corporate, other than a limited liability partnership.

b) An officer or employee of the company.

c) A person who is a partner of an officer or employee of the company, or a person who is in the employment of an officer or employee of the company.

d) A person who, or his relative, or his partner is holding any security in the company, or its subsidiary company, or its holding company, or its associate company, or a subsidiary of such holding company.

Or

A person who, or his relative, or his partner is indebted in excess of INR 5 Lakhs, to the company, or its subsidiary company, or its holding company, or its associate company, or a subsidiary of such holding company.

Or

A person who, or his relative, or his partner has given a guarantee or provided any security in connection with the indebtedness of any third person, in excess of INR 1 lakh, to the company, or its subsidiary company, or its holding company, or associate company, or a subsidiary of such holding company.

Note: However, a person shall not be disqualified if his relative holds any security in the company of face value not exceeding INR 1 lakh.

Note: If a relative acquires any security exceeding INR 1 lakh, then, the auditor shall take the corrective action within next 60 days so as to maintain the limit of INR 1 lakh.

e) A person or a firm who, whether directly or indirectly, has business relationship of such nature as may be prescribed with-

➢ the company, or
➢ its subsidiary company, or
➢ its holding company, or
➢ associate company, or
➢ a subsidiary of such holding company, or
➢ a subsidiary of such associate company.

As per Rule 10, the term ‘business relationship’ shall be construed as any transaction entered into for a commercial purpose, except-</td></tr>
</table>

	i) Commercial transaction which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Companies Act, 2013 or the Chartered Accountants Act, 1949; ii) 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 telecommunication, 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 KMP. 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 person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20 companies. **Note:** While computing the limit of 20 companies, appointment held in one-person companies, dormant companies, small companies and private companies having paid-up share capital less than INR 100 crore shall not be considered. h) A person who has been convicted by a court of an offence involving fraud and a period of 10 years has not elapsed from the date of such conviction. i) *A person, who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company.*
Example 1	Mr. A, a Chartered accountant has been appointed as an auditor of Laxman Ltd. in the Annual General Meeting of the company held in September, 2018, in which he accepted the assignment. Subsequently, in January, 2017 he joined B, another Chartered Accountant, who is the Manager Finance of Laxman Ltd., as partner. **Answer** **Provisions and Explanation:** Section 141(3) (c) of the Companies Act, 2013 prescribes that any person who is a partner or in employment of an officer or employee of the company will be disqualified to act as an auditor of a company. Sub-section (4) of Section 141 provides that an auditor who becomes subject, after his appointment, to any of the disqualifications specified in sub-sections (3) of Section 141, he shall be deemed to have vacated his office as an auditor. **Conclusion:** In the present case, A, an auditor of M/s Laxman Ltd., joined as partner with B, who is Manager Finance of M/s Laxman Limited, has attracted clause (3) (c) of Section 141 and, therefore, he shall be deemed to have vacated office of the auditor of M/s Laxman Limited.
Example 2	"Mr. A", a practicing Chartered Accountant, is holding securities of "XYZ Ltd." having face value of INR 900/-. Whether Mr. A is qualified for appointment as an Auditor of "XYZ Ltd."? **Answer** As per section 141 (3)(d) (i), an auditor is disqualified to be appointed as an auditor if he, or his relative or partner 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: In the present case, Mr. A. is holding security of INR 900 in the XYZ Ltd, therefore he is not eligible for appointment as an Auditor of "XYZ Ltd".
Example 3	"Mr. P" is a practicing Chartered Accountant and "Mr. Q", the relative of "Mr. P", is holding

	securities of "ABC Ltd." having face value of INR 90,000/-. Whether "Mr. P" is qualified from being appointed as an Auditor of "ABC Ltd."? **Answer** As per section 141 (3)(d)(i) an auditor is disqualified to be appointed as an auditor if he, or his relative or partner 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: Further as per proviso to this Section, the relative of the auditor may hold the securities or interest in the company of face value not exceeding of INR 1,00,000. In the present case, Mr. Q. (relative of Mr. P, an auditor), is having securities of INR 90,000 face Value in the ABC Pvt. Ltd., which is as per requirement of proviso to section 141 (3)(d)(i), Therefore, Mr. P will not be disqualified to be appointed as an auditor of ABC Ltd.
Example 4	"BC & Co." is an Audit Firm having partners "Mr. B" and "Mr. C", and "Mr. A" the relative of "Mr. C", is holding securities of "MWF Ltd." having face value of INR 1,01,000/-. Whether "BC & Co." is qualified from being appointed as an Auditor of "MWF Ltd."? **Answer** As per section 141 (3)(d) (i), an auditor is disqualified to be appointed as an auditor if he, or his relative or partner 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. Further as per proviso to this Section, the relative of the auditor may hold the securities or interest in the company of face value not exceeding of INR 1,00,000. In the instant case, BC & Co, will be disqualified for appointment as an auditor of MWF Ltd as the relative of Mr. C i.e., partner of BC & Co., is holding the securities in MWF Ltd which is exceeding the limit mentioned in proviso to section 141(3)(d)(i).
Example 5	"ABC & Co." is an Audit Firm having partners "Mr. A", "Mr. B" and "Mr. C", Chartered Accountants. "Mr. A", "Mr. B" and "Mr. C" are holding appointment as an Auditor in 4, 6 and 10 Companies respectively. a) State the maximum number of Audits remaining in the name of "ABC & Co." b) Also, State the maximum number of Audits remaining in the name of individual partner i.e., Mr. A, Mr. B and Mr. C. **Solution** **Fact of the Case:** In the instant case, Mr. A is holding appointment in 4 companies, whereas Mr. B is having appointment in 6 Companies and Mr. C is having appointment in 10 Companies. In aggregate all three partners are having 20 audits. **Provisions and Explanations:** As per section 141(3)(g) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies; As per section 141 (3)(g), this limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be 3 × 20 = 60 company audits. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account. **Conclusion:** a) Therefore, ABC & Co. can hold appointment as an auditor of 40 more companies:

	<table><tr><td>Total Number of Audits available to the Firm = 20*3</td><td>60</td></tr><tr><td>Number of Audits already taken by all the partners in their individual capacity = 4+6+10</td><td>20</td></tr><tr><td>Remaining number of Audits available to the Firm</td><td>40</td></tr></table> b) With reference to above provisions, an auditor can hold more appointment as auditor = ceiling limit as per section 141(3)(g) - already holding appointments as an auditor. Hence, i) Mr. A can hold: 20 – 4 = 16 more audits ii) Mr. B can hold 20 - 6 = 14 more audits and iii) Mr. C can hold 20-10 = 10 more audits. **Note:** It has been assumed that the companies given in the question are not one person companies, dormant companies, small companies and private companies having paid-up share capital less than INR 100 crore.
Vacation of office [Sec. 141(4)]	▪ If after appointment, an auditor incurs any of the disqualification mentioned in sec. 141(3), he shall vacate his office as such auditor. ▪ Such vacation shall be deemed to be a casual vacancy in the office of auditor.

15. Remuneration of Auditors [Sec. 142]

Remuneration to be fixed in GM	The remuneration of the auditors of a company shall be fixed- a) in the general meeting; or b) in such manner as may be decided in the general meeting
Remuneration to be fixed by the Board	In case the first auditor is appointed by the Board, the remuneration of the first auditor shall be fixed by the Board.
Certain sums to be included in remuneration	▪ The remuneration shall, in addition to the fee payable to an auditor, include- a) the expenses, if any, incurred by the auditor in connection with the audit of the company; and b) any facility extends to the auditor ▪ However, the remuneration shall not include any remuneration paid to the auditor for any other service rendered by him at the request of the company.
MCQ	SHRD Private Ltd is engaged in the business of software and consultancy. The company has an annual turnover of INR 2,000 crores but its profit margins are not very good as compared to the industry standards. For the financial year ended 31 March 2019, the company proposed appointment of its statutory auditors at its Board meeting, however, the remuneration was not finalized. The statutory auditors completed the engagement formalities including the engagement letter between the company and the auditors and it was decided that the engagement letter be signed without fee i.e., with the clause that the fee to be mutually decided. Please provide your views on this. a. Such engagement letter is not valid. b. Engagement letter with such arrangement is valid. c. Engagement letter should specify the fee of last year, if applicable, if the fee for the current year is not yet finalized at the time of signing of the engagement letter.

	d. Engagement letter should specify 10% increase in the fee as compared to last year as per the norms of the ICAI, in case the fee is not finalized at the time of signing of the engagement letter.

16. Powers and Duties of Auditors and Auditing Standards [Sec. 143]

16.1 Rights	
Rights of access to books	▪ The auditor shall have access, at all times, to the books of account and vouchers of the company. ▪ His right extends to all the books, whether kept at the registered office of the company or at any other place. ▪ The auditor shall also have access to the records of all the **subsidiaries and associates** of the company, in so far as access to the books of subsidiaries is required for the purpose of consolidation of financial statements of the company with its subsidiaries and associates.
Rights to require information	▪ The auditor 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.
16.2 Duties	
Duty to make inquires	a) Whether loans and advance 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 ➢ 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.

Duty to make report [sec. 143(2)]	▪ The auditor shall make a report to the members of the company. ▪ In his audit report, the auditor shall report on- a) the accounts examined by him; and b) financial statements which are required to be laid before the company in general meeting. ▪ The auditor shall state in his report as to whether the accounts examined by him and financial statements give a true and fair view of- a) the state of the company's affairs as at the end of its FY; b) the profits or loss for the year; and c) cash flow for the year. ▪ The auditor shall state in his report such other matters as may be prescribed. ▪ The auditor shall prepare his report after taking into account the provisions of this Act, the Accounting standards and the Auditing standards.
Report on principal assertions [sec. 143(3)]	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 ➢ 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 by a person other than the company's auditor ➢ has been sent to him ➢ 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 opinions, ➢ 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 directors are 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 control system with reference to financial statement* in place and the *operating effectives* of such controls This requirement shall not apply to a private company-

	i) Which is OPC or a small company; or ii) Which has turnover less than INR 50 crore as per latest audited FS and which has aggregate borrowing from banks or financial institutions or anybody corporate at any point of time during the FY less than INR 25 crore. j) Such other matters as may be prescribed.
Other matters to be included in auditor's report (rule 11)	The auditor shall include in his report, his views and comments on the following matters: a) Whether the company has disclosed the impact, if any, of pending litigations on financial position in its financial statement. b) Whether the company has made provisions 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. d) Whether the Company has provided requisite disclosures in its FS as to holdings as well as dealings in specified Bank Notes during the period from 8th November, 2016 to 30th December 2016 and if so, whether these are in accordance with the books of accounts maintained by the Company.
Reasons to be given [sec. 143(4)]	Where any of the matters required to be included in the audit report is answered in the negative or with a qualification, the report shall state the reasons thereof.
Additional Matters (CARO)	In case of specified companies, the auditor's report shall also include a statement on such additional matters as specified in CARO 2016 [Companies (Auditor's Report) Order 2016].
Reporting of Frauds	Discussed Later
Example	MNO Ltd is a listed company engaged in the business of trading of various products. The company also plans to start manufacturing of certain products which are currently traded. During the course of its audit, the auditors completed all the procedures related to audit of financial statements. However, the auditor got stuck on one procedure because of which audit has not got concluded. Auditors are waiting for certain additional information – Directors report and Management Discussion and Analysis (MD&A) for their review. However, the management is not ready with this information and wants the auditors to complete their work without review of this information. Please advise as per the legal requirements. **Solution:** In the given case, the requirement of the auditors regarding additional information i.e., Directors report and MD&A without which they have not been able to conclude the audit doesn't look valid. The auditor is required to audit the financial statements and express an opinion on the same. The auditor does not audit these additional informations. Hence the auditor should conclude the work without delaying because of this additional information.

17. Special Provisions W.R.T Government Companies [Sec. 143(5), (6) and (7)]

Directions by CAG to the auditor [sec. 143(5)]	▪ In the case of a Government Company or any other company owned or controlled directly or indirectly, by CG or SG or partly by CG and SG(s) or partly by CG and partly by SG(s), CAG shall direct the auditor the manner in which the accounts of the Government Company are required to be audited.

	▪ The auditor shall submit a copy of his audit report to CAG. ▪ The audit report shall, among other things, include- a) the directors, if any, issued by CAG; b) the action taken in the pursuance of directions issued by CAG; and c) the impact on the accounts and financial statements of the company.	
Rights of CAG to conduct supplementary audit or supplement the audit report [sec. 143(6)]	CAG shall, within 60 days from the date of receipt of the audit report, have the following rights:	
	Supplementary audit	▪ CAG may order conduct of a supplementary audit of the financial statement of the company. ▪ Supplementary audit shall be conducted by such person (s) as CAG may authorise in this behalf. ▪ CAG may authorise such person(s) to obtain such information as may be required for conduct of supplementary audit.
	Supplement or comment	▪ CAG may comment upon the audit report. ▪ CAG may supplement the audit report. ▪ Any such comments or supplement shall be sent by the company to every person entitled to copies of audited financial statements. ▪ Any such comments or supplement shall also be placed before the members in the AGM at the same time and in the same manner as the audit report.
Test audit [sec. 143(7)]	CAG may, by an order, cause test audit to be conducted of the accounts of a Government Company.	

18. Monitoring and Enforcing Compliance with Auditing Standards by NFRA

(1) For the purpose of monitoring and enforcing compliance with auditing standards (SA) under the Act by a company or a body corporate governed under Rule 3, the NFRA may:

i) review working papers (including audit plan and other audit documents) and communications related to the audit;

ii) evaluate the sufficiency of the quality control system of the auditor and the manner of documentation of the system by the auditor; and

iii) perform such other testing of the audit, supervisory, and quality control procedures of the auditor as may be considered necessary or appropriate.

(2) The NFRA may require an auditor to report on its governance practices and internal processes designed to promote audit quality, protect its reputation and reduce risks including risk of failure of the auditor and may take such action on the report as may be necessary.

(3) The NFRA may seek additional information or may require the personal presence of the auditor for seeking additional information or explanation in connection with the conduct of an audit.

(4) The NFRA shall perform its monitoring and enforcement activities through its officers or experts with sufficient experience in audit of the relevant industry.

(5) The NFRA shall publish its findings relating to non-compliances on its website and in such other manner as it considers fit, unless it has reasons not to do so in the public interest and it records the reasons in writing.

(6) The NFRA shall not publish proprietary or confidential information, unless it has reasons to do so in the public interest and it records the reasons in writing.

(7) The NFRA may send a separate report containing proprietary or confidential information to the Central Government for its information.

(8) Where the NFRA finds or has reason to believe that any law or professional or other standard has or may have been violated by an auditor, it may decide on the further course of investigation or enforcement action through its concerned Division.

Overseeing the quality of service and suggesting measures for improvement (As per NFRA Rules)

(1) On the basis of its review, the NFRA may direct an auditor to take measures for improvement of audit quality including changes in their audit processes, quality control, and audit reports and specify a detailed plan with time-limits.

(2) It shall be the duty of the auditor to make the required improvements and send a report to the NFRA explaining how it has complied with the directions made by the NFRA.

(3) The NFRA shall monitor the improvements made by the auditor and take such action as it deems fit depending on the progress made by the auditor.

(4) The NFRA may refer cases with regard to overseeing the quality of service of auditors of companies or bodies corporate referred to in rule 3 to the Quality Review Board constituted under the Chartered Accountants Act, 1949 (38 of 1949) or call for any report or information in respect of such auditors or companies or bodies corporate from such Board as it may deem appropriate.

(5) The NFRA may take the assistance of experts for its oversight and monitoring activities.

19. Branch Audit [Sec. 143(8)]

Branch in India - appointment of auditor	The accounts of any branch office in India, shall be audited by- a) the company's auditor; or b) any other person qualified for appointment as an auditor of the company.
Branch outside India - appointment of auditor	The accounts of any branch office outside India, shall be audited by- a) the company's auditor; or b) 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.
Duties and powers of the company's auditor	a) The duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor if any shall be as contained in sub sections (1) to (4) of sec. 143. b) The provisions regarding reporting of fraud by the auditor shall also extend to such branch auditor, to the extent it relates to the concerned branch.
Report of Branch Auditor	▪ The branch auditor shall prepare a report on the accounts of the branch examined by him. ▪ The branch auditor shall send his report to the auditor of the company. ▪ The auditor of the company shall deal with the report of the branch auditor, in his report in such manner as he considers necessary.

20. Auditor to Comply with Auditing Standards [Sec. 143(9) and (10)]

Nature of duty	Every auditor shall comply with the auditing standards.

CG to prescribe auditing standards	Stages in prescribing the auditing standards are as follows: i) At the first stage, ICAI recommends the standards of auditing. ii) At the second stage, these standards of auditing shall be examined by the National Financial Reporting Authority (NFRA). NFRA may also make its own recommendations. iii) At the third stage, CG examines the recommendations made by NFRA. Then, CG may prescribe, after consultation with NFRA, the auditing standards.
Position until auditing standards are notified	Until any Auditing Standards are notified, any standards or standards of auditing specified by ICAI shall be deemed to be the auditing standards.

21. Reporting of Fraud by an Auditor [Sec. 143(12) to (15)]

Reporting of frauds involving INR 1 crore or above [sec. 143(12)]	a) If an auditor of a company has reasons to believe that a fraud which involves or is expected to involve individually an amount of INR 1 crore or above, is being or has been committed in the company by its officer or employees, the auditor shall report the matter to the Central Government. b) The auditor shall report such fraud in the following manner: 1) The auditor shall report such fraud to the audit committee or to the Board immediately but not later than 2 days of his knowledge of the fraud. The auditor shall seek the reply or observations of the audit committee of the Board, within 45 days. 2) If the auditor receives the reply or observation of the audit committee or the Board, the auditor shall, within 15 days of receipt of such reply or observations, forward to the Central Government- a) his report; b) the reply or observations of the audit committee or the Board; and c) his comments on the reply or observations of the audit committee or the Board. 3) If the auditor fails to receive the reply or observation of the audit committee or the Board within 45 days, he shall forward to the Central Government a) his report; and b) a note containing the details of his report that was earlier forwarded to the Board or audit committee for which he has not received any reply. 4) The report shall be sent- ➢ to the Secretary, Ministry of Corporate Affairs ➢ in a sealed cover ➢ by registered post with acknowledgment due or by speed post. 5) After the report is sent, an e-mail shall also be sent to the Secretary, Ministry of Corporate Affairs in confirmation of the report sent. 6) The report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number. 7) The report shall be signed by the auditor with his seal and shall indicate his membership number.

	8) The report shall be in the form of a statement as specified in for ADT-4. 9) These provisions shall also apply, mutatis mutandis, to- a) A cost auditor during the performance of his duties u/s 148; and b) A secretarial auditor during the performance of his duties under section 204.
Reporting of frauds involving less than INR 1 crore [Sec. 143 (12)]	a) In case of a fraud involving lesser than INR 1 crore, the auditor shall report the matter to- i) the audit committee constituted under section 177; or ii) the Board, in case the company is not required to constitute the audit committee. b) The auditor shall report such fraud immediately but not later than 2 days of his knowledge of the fraud. c) The auditor shall specify the following points in his report i) Nature of fraud with description; ii) Approximate amount involved; and iii) Parties involved. c) The company shall disclose the details about such frauds in the Board's report. Following details of each such fraud shall be disclosed in the Board's report: i) Nature of fraud with description; ii) Approximate account involved; iii) Parties involved, if remedial Action is not taken; and iv) Remedial actions taken.
No liability of auditor [sec. 143(13)]	An auditor shall not be deemed to be guilty for breach of any of his duties by reason of his reporting any matter to the Central Government if such reporting is done in good faith.
Provisions applicable to other auditors [sec. 143(14)]	The provisions w.r.t. reporting of fraud shall mutatis mutandis apply to- a) The cost accountant conducting cost audit under section 148; or b) The company secretary in practice conducting secretarial under section 204.
Punishment for non-compliance [sec. 143(15)]	▪ Minimum fine INR 1 lakh ▪ Maximum fine INR 25 lakh.
Example	NSH Ltd is engaged in the business of retail and is listed on National stock exchange. The company recently acquired a business undertaking to expand its business. During the year, certain transactions amounting to thousands of rupees were carried out by the employees/ Directors of the company which the management found suspicious and appointed a forensic consultant to carry out their review. Pursuant to this review process, certain suspect transactions were identified by the management and the management reported these transactions to the appropriate authorities. During the course of statutory audit, such transactions were also made known to the statutory auditors. How should the auditor have dealt with such matter? **Solution:** The auditors need to report about this matter appropriately in their CARO report. As per Section 143(12) of the Companies Act, 2013, the auditor is required to report to the Audit Committee or to the Board of Directors and, where applicable, to the Central Government an offence of fraud in the company by its officers or employees only if he is the

	first person to identify/note such instance in the course of performance of his duties as an auditor. In this case, the suspicious transactions have been identified by the management first and information about the same has been given by the management to the auditor. Accordingly, the auditor should report about this matter to the Audit Committee/ Board of Directors but the auditor would not be required to report the same to Central Government.

22. Auditor Not to Render Certain Services [Sec. 144]

Services to be approved	An auditor shall provide to the company only such other services as are approved by- a) the Board of directors; or b) the audit committee, as the case may be.	
Prohibited services	An auditor shall not provide any of the following services (whether such services rendered directly or indirectly to the company or its holding company or subsidiary company): 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 i) Any other kind of services as may be prescribed (No service has been prescribed so far).	
Discontinuation of existing non-audit services	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 FY after the date of such commencement.	
Meaning of directly and indirectly	For the purpose of this sub-section, the term directly or indirectly shall include rendering of service by the auditor-	
	In case of auditor being an individual-	➢ either himself or ➢ through his relative or ➢ any other person connected or associated with such individual or ➢ through any other entity, in which such individual has significant influence or control, or; whose name or trade mark or brand is used by such individual.
	In case of auditor being a firm-	➢ either itself or ➢ through any of its partners or ➢ through its parent, subsidiary or associated entity or ➢ through any other entity, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners.
MCQ	MNP Ltd is a medium-sized company engaged in the business of pharmaceuticals. For the	

	year ended 31 March 2018, the company is looking for appointment of GST (Goods and Services Tax) auditor. The company wants to appoint somebody for this work who is familiar with the business of the company i.e., who would have worked with the company in the past so that lesser efforts are required to get the GST audit completed. The company has following options, please suggest which one would be better for the company. a. Statutory auditors can be appointed for this work. b. Internal auditors can be appointed for this work. c. Both statutory and internal auditors can be jointly appointed for this work. d. Internal auditors along with the tax consultants of the company can be appointed for this work.

23. Auditor to Sign Audit Reports, etc. [Sec. 145]

Signing and certification	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 ➢ in accordance with the provisions of section 141 (2) (i.e., in case of firm including LLP, only Chartered Accountants are authorised to act and sign).
Qualifications to be read in general meeting and inspection thereof	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- a) read before the company in general meeting; and b) open to inspection by any member of the company.
MCQ	GP & Co LLP is a firm of Chartered Accountants having 35 partners. The firm has 9 branches across India. The firm was appointed as statutory auditor of PQR Ltd for the year ended 31 March 2018. The firm designated Mr. NG Goel as the signing and engagement partner for the statutory audit of PQR Ltd. During the course of audit, NG Goel was fully involved; however, the finalization of financial statements took long and the time when they got finalized, NG Goel had to travel for some urgent work for a month outside India. As regards the signing of the financial statements, please suggest which of the following options is correct? a. PQR Ltd should wait till the time NG Goel returns and if required, NG Goel can sign the financial statements back dated. b. PQR Ltd should wait till the time NG Goel returns and only after that financial statements will be signed. c. In the absence of NG Goel, any other partner of the firm, being a CA, can sign the financial statements of PQR Ltd. d. In the absence of NG Goel, any other partner of the firm, being a CA, can sign the financial statements of PQR Ltd, but the firm should intimate about the same to the ROC and Income Tax authority.

24. Auditors to Attend General Meeting [Sec. 146]

Right of the auditor to	All notices of, and other communications relating to, ➢ any General Meeting,

receive notices of general meeting	➢ shall be forwarded to the auditor of the company.
Duty of the auditor to attend General Meeting	▪ The auditor shall attend the general meeting. ▪ The auditor may attend the general meeting- a) himself; or b) through his authorised representative, who shall also be qualified to be an auditor. ▪ The company may exempt an auditor from attending the general meeting.
Right of the auditor to be heard at general meetings	The auditor shall have a right to be heard at a general meeting on any part of the business which concerns him as the auditor.

25. Punishment for Contravention [Sec. 147]

Punishment for contravention of sec. 139 to 146	***Punishment for the company***	▪ Minimum fine: INR 25,000 ▪ Maximum fine: INR 5,00,000
	Punishment for officer in default	▪ Maximum imprisonment: 1 year ▪ Minimum fine: INR 10,000 ▪ Maximum fine: 1,00,000
Punishment for the auditor for contravention of sec. 139, 143, 144 and 145	▪ Minimum fine: INR 25,000 ▪ Maximum fine: INR 5,00,000 or four times the remuneration of the auditor; whichever is less. If a contravention is committed knowingly or wilfully with the intention to deceive the company or its shareholders or creditors or tax authorities, then punishment shall be- ▪ Maximum imprisonment: 1 year ▪ Minimum fine: INR 50,000 ▪ Maximum fine: INR 25,00,000 or eight times the remuneration of the auditor; whichever is less.	
Consequences of conviction of auditor for contravention of sec. 139, 143, 144 and 145	***Refund of remuneration***	The auditor shall be liable to refund to the company the remuneration received by him.
	Payment of damages by the auditor	The auditor shall be liable to pay damages ➢ to the company/ statutory bodies or authorities/ **members/ creditors** ➢ for loss arising out of incorrect or misleading statement of particulars made in his audit report.
Measures to ensure prompt payment of damages	a) For ensuring prompt payment of damages by the auditor, CG shall, by notification, specify any statutory body/authority / an officer. b) Such statutory body/ authority / officer shall pay the damages to the persons entitled to damages. c) Such statutory body/ authority / officer shall file a report with CG containing particulars of damages.	
Jointly and several liabilities of partners	In case of auditor being an audit firm, ➢ the liability (whether civil or criminal)	

	➢ shall be of the partner (s) concerned and of the firm jointly and severally. However, in case of criminal liability of an audit firm, in respect of liability other than fine, the concerned partner or partners, who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable.

26. Power of CG to order Maintenance of Cost Records and Conduct of Cost Audit [Sec 148]

Order by CG for maintenance of cost records	***Whether mandatory?***	Maintenance of cost records is mandatory only if such an order is made by CG.
	Order for which companies?	a) Such class of companies as are engaged in the production of such goods as may be prescribed. b) Such class of companies providing such services as may be prescribed.
	Nature of cost records to be maintained	Prescribed particulars relating to – i) The utilisation of material; ii) Labour; and iii) Other items of cost.
	Consultation before making order	Before issuing any such order ➢ in respect of any class of companies regulated under a special Act, ➢ CG shall consult the regulatory body constituted or established under such special Act.
Order by CG for conduct of cost audit	**Whether mandatory?**	Conduct of cost audit is mandatory only if such an order is made by CG.
	Order for which companies?	Such class of companies for which CG has made an order for maintenance of cost records; and ➢ Which have- ▪ Net worth of such amount as may be prescribed; or ▪ Turnover of such amount as may be prescribed.
	Manner	Cost audit shall be conducted in the manner specified in the order made by CG.
Appointment of cost auditor by Board	▪ Cost audit shall be conducted by a **cost accountant**. ▪ Only a cost accountant or a firm of cost accountants can be appointed as a cost auditor. ▪ The cost auditor shall be appointed by the Board. ▪ The cost audit shall be in addition to the audit conducted u/s 143. ▪ The auditor appointed u/s 139 shall not be appointed as the cost auditor. ▪ The remuneration of the cost auditor shall be determined by the members in such manner as may be prescribed. ▪ The company shall give all assistance and facilities to the cost auditor.	
	Procedure for appointment and fixation of remuneration of the cost auditor (Rule 14)	
	Case I	**Case II**

	The company is required to constitute an audit committee	The company is not required to constitute an audit committee
	▪ The Board shall appoint the cost auditor on the recommendations of the audit committee. ▪ The audit committee shall recommend the remuneration of the cost auditor. ▪ The remuneration of the cost auditor shall be considered and approved by the Board and subsequently by the members.	▪ The Board shall appoint the cost auditor. ▪ The remuneration of the cost auditor shall be fixed by the Board and subsequently approved by the members.
Compliance with cost auditing standards	▪ The cost auditor shall comply with the cost auditing standards. ▪ 'Cost auditing standards' mean such standards as are issued by the Institute of Cost Accountants of India, with the approval of CG.	
Disqualifications, rights and duties of cost auditor	The qualification, disqualification, rights, duties and obligations ➢ applicable to auditor u/s 141 and 143 shall, so far as may be applicable, ➢ apply to the cost auditor.	
Cost audit report	▪ The cost auditor shall submit his report to the Board of directors. ▪ Within 30 days of receipt of cost audit report, the company shall furnish to CG- i) A copy of the cost audit report in e-form CRA 4; and ii) full information and explanation on every reservation or qualification contained in the cost audit report. ▪ CG may call for such further information and explanation as it may deem fit. ▪ The company shall furnish such further information and explanation within such time as specified by CG.	

ARISE AWAKE AND STOP NOT TILL YOUR GOAL IS ACHIEVED

-Swami Vivekanand

About CA Kishan Kumar

- ★ Kishan Kumar is an **Associate member** of The Institute of Chartered Accountants of India.
- ★ He is a **throughout Rankholder** in CA examinations.
- ★ He himself scored **Exemption in EIS-SM** in his CA Inter Exam..
- ★ He has been **awarded by Nitish Kumar, Hon'ble Chief Minister** of Bihar for his excellence in the field of education.
- ★ Internationally renowned **University of South Wales** has also felicitated him for his aptitude and achievements during his academic life.
- ★ Kishan has worked with **Ernst & Young and PwC (Big 4 Firms)** and uses his practical corporate experience to make the subject more interesting and engaging.
- ★ His students have secured **marks as high as 85** and hundreds have scored exemptions.
- ★ He is committed to make meaningful contribution to the life of promising CA aspirants.

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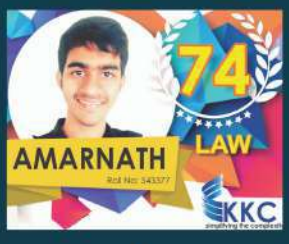

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