



CS R. Sridharan
PRESIDENT

MCA: 2014

02nd June, 2014

Respected *Sir*

Sub: Rules notified under the Companies Act, 2013

Government has recently notified various rules to operationalize the Companies Act, 2013. The following three issues have substantial bearing on compliance and governance in corporate sector and the profession of company secretaries:

- a. Appointment of company secretaries in companies under section 203 of the Act;
- b. Secretarial audit in bigger companies under section 204 of the Act; and
- c. Pre-certification of e-forms filed by companies on MCA 21.

These have been elaborated in Annex 1, 2 and 3 respectively of this letter. We request you to kindly address these issues immediately so that the law settles down quickly and the mechanism of compliance and governance in corporate sector is strengthened further.

With best regards,

Yours sincerely,

(CS R. Sridharan)

Shri Arun Jaitley
Hon'ble Union Minister for Finance, Corporate Affairs and Defence
Government of India
North Block, New Delhi

Encl.: As above.

Key Managerial Personnel

What it is: The Act requires every company belonging to such class or classes of companies as may be prescribed shall have whole-time key managerial personnel, including a company secretary. It also specifies the functions of company secretary and qualification to be a company secretary.

Purpose: Company secretary must ensure compliance with all applicable laws, secretarial standards and all governance norms.

History:

(a) The Standing Committee on Finance had examined the Companies Bill, 2009. The said Bill had proposed every company belonging to such class or description of companies as may be prescribed shall have whole-time KMP. ICSI had then suggested that the Bill may be specific and suggested that every company with a paid up share capital of Rs.5 crore should have KMP. The Ministry had then replied that there may be a need for revising the limit from time to time and hence the limit may not be specified in the Act. If the limit has to be specified, it had suggested an alternate formulation that every company having a paid up capital of Rs.5 crore or more or such other amount as may be prescribed from time to time shall have KMP. The Ministry has, therefore, committed before the legislature that companies above a threshold in terms of capital will have KMPs. Based on this understanding, the Companies Act, 2013 has been enacted.

(b) The draft rules notified in August / September 2013 under the Companies Act, 2013 carried this intention and reiterated the paid up capital as the basis of classification. These Rules specified that the companies with a threshold of capital shall have KMP. These did not distinguish between private companies and public companies.

(c) This approach is continuation of the approach followed in the Companies Act, 1956 under which companies with a threshold of capital were required to have company secretaries.

New Rules

The rules do not require KMPs in public companies with less than Rs.10 crore of capital and in all private companies.

Concerns

- a. The rule has kept out more than 99.5% of companies from the purview of KMP.
- b. The Act envisages classification, not grouping of companies. A company chooses to be private company or public company. Whether a company is a private or public reflects its character, and, therefore, grouping, not classification.
- c. The subordinate legislation aims to further the objects of legislation. The classification must, therefore, have a nexus with the purpose. There is no nexus in grouping companies as private or public as regards compliance or governance is concerned. It is not that private companies are immune from misdemeanour. It is not that private companies are not important for the economy or country.

Suggestion

The Rules may be amended to put companies in different classes and prescribe requirement of KMPs as may be warranted for each class. While a very big company may need to have all three kinds of KMPs, companies of with at least Rs.5 crore of paid up capital must have at least a company secretary.

Secretarial Audit

What it is: The Act requires bigger companies to have secretarial audit.

Purpose: Since it is an audit of compliances of applicable laws, this gives comfort to all stakeholders.

History: The legislative intention of section 204 is evident from the **report of the Standing Committee on Finance (SCF), which had examined the Companies Bill, 2009**. The Ministry had submitted before the SCF as under:

“Secretarial Audit gives a necessary comfort to the investors that the affairs of the company are being conducted in accordance with the legal requirements and also protects the companies from the consequences of noncompliance of the provisions of the Companies Act and other important corporate laws. It is, accordingly, felt and suggested that the Bill may provide for requirement of conduct of secretarial audit by at least bigger companies by a company secretary in practice.”

Based on this recommendation, the Ministry proposed to the SCF that it would include a new clause in the Bill as under:

“Every company having a paid up share capital of rupees five crore or more or such other amount as may be prescribed by Central Government from time to time shall annex with its Board’s Report made in terms of sub-section (3) of section 120 of the Act, a Secretarial Audit Report given by a company secretary in practice in such form as may be prescribed.”

The Ministry has, therefore, committed before the legislature that companies above a threshold in terms of capital will have secretarial audit. Based on this understanding, the Companies Act, 2013 has been enacted. The requirement of secretarial audit is, therefore, necessarily linked to size of capital.

Rules: The rules do not require secretarial audit in public companies below a threshold and in all private companies irrespective of size.

Concerns

- (a) The Act requires every listed company, big or small, and every other company which is not ‘small’, needs secretarial audit. The need for a company to have secretarial audit company can be linked to scale of operations or presence which can be determined in terms of paid up capital, turnover, number of employees, number of shareholders, outstanding borrowings, kind of business, etc. and has no link whether a company is public or private.
- (b) A company chooses to be private company or public company. Whether a company is a private or public reflects its character, and, therefore, grouping, not classification. Further the subordinate legislation aims to further the objects of legislation. The classification must, therefore, have a nexus with the purpose. There is no nexus in grouping companies as private or public as regards compliance or governance is concerned.
- (c) The exclusion of private companies, irrespective of their size, from secretarial audit gives a message that the matters covered under such audit such as compliance with applicable laws is not important from public interest and governance perspective.

Suggestion

The rules may be amended to provide for secretarial audit for all listed companies – big or small, and every other company which is not a ‘small company’. At the least, the secretarial audit must be made applicable, to start with, to those companies having a paid up share capital of Rs.50 crore or more, or a turnover of Rs.200 crore or more, or outstanding loans or borrowings from banks or PFIs exceeding Rs.100 crore at any point of time during the preceding financial year.

Pre-Certification

What it is: The e-forms loaded into MCA 21 are pre-certified by professionals.

Purpose: Data integrity and availability of prompt and accurate information to stakeholders.

History:

(a) **Department Related Parliamentary Standing Committee, which examined the Companies (Second Amendment) Bill, 1999**, while endorsing the pre-certification in its 64th Report in 2000, observed that verification of compliances with the provisions of the Companies Act, 1956 by a company secretary in practice was necessary.

(b) **The High Level Committee (Naresh Chandra Committee) on Corporate Audit and Governance in its report in 2002**, while observing wide gap between prescription and practice, recommended a system of pre-certification by company secretaries to **remove defects in documents so that these could be taken on record immediately and to reduce workload on Ministry**. It also recommended that the system should provide for monetary and other penalties on company secretaries who certify incorrectly, even though error or oversight.

(c) Accordingly, **the Companies (Amendment) Bill, 2003 sought to add a new section 383C** to provide that all documents, returns, forms required to be filed with the Registrar or any statutory authority shall be pre-certified by a company secretary in whole-time practice.

(d) In the meantime, Government came out with the **Concept Paper for revamping of Company Law on August 8, 2004** containing a model codified company law which incorporated the provisions of section 383C of the 2003 Bill.

(e) Pending enactment of the new company law, the Ministry introduced pre-certification by circulars.

(f) The process has been now been sanctified in the Companies (Registration of Offices and Fees) Amendment Rules, 2014.

Who Pre-certifies? Though it was intended to be pre-certified by company secretaries, these are being done by all three kinds of professionals.

New Rules:

(a) Pre-certification is not required for e-forms filed by 70% of the companies.

(b) Pre-certification of a critical form, AOC-4 has been reserved for one kind of professional.

Concerns:

(a) Since small companies are not subject to annual returns, secretarial audit, key managerial personnel, etc., this would adversely affect compliance with laws;

(b) If these are not pre-certified by company secretaries, the quality of certification would be suspect; and

(c) 70% of data in MCA system would be unauthenticated.

Suggestion: All e-forms filed by all companies need to be pre-certified by company secretaries who are trained in regulatory compliance.