MCA amends provisions relating to independent directors under the Companies Act, 2013

14 July 2017

Background
The Companies Act, 2013 (2013 Act) became largely effective from 1 April 2014. The Ministry of Corporate Affairs (MCA) has been issuing various amendments and clarifications to the 2013 Act and to the corresponding Rules to remove practical challenges faced by companies while implementing certain provisions of the 2013 Act.

New development
Recently, on 5 July 2017, the MCA amended certain provisions relating to independent directors and issued the following notifications:

• Companies (Appointment and Qualification of Directors) Amendment Rules, 2017
• Amendment to Schedule IV (Code for independent directors) of the 2013 Act.

Overview of the amendments
Companies (Appointment and Qualification of Directors) Amendment Rules, 2017

Existing requirements
As per Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014, unlisted public companies are required to have at least two independent directors, if they meet any one of the following criteria1:

a) Paid-up share capital of INR10 crore or more
b) Turnover of INR100 crore or more, or
c) Outstanding loans/debentures/deposits exceeding INR50 crore.

If an unlisted public company is required to appoint a higher number of independent directors due to composition of its audit committee, then such an unlisted public company would have to appoint a higher number of independent directors.

Further, the rule provides that any intermittent vacancy of an independent director should be filled-up by the board at the earliest but not later of the following dates:

a) Immediate next board meeting or
b) Three months from the date of such vacancy.

However, in case a company does not meet any of the above given thresholds relating to appointment of an independent director for a consecutive period of three years, then such a company is not required to appoint independent directors till such time it meets any of the above conditions.

1The paid-up share capital or turnover or outstanding loans/debentures/deposits existing on the last date of latest audited financial statements should be taken into account.
One point to note here is that though the rule provides that an intermittent vacancy of an independent director should be filled up within three months, the Schedule IV to the 2013 Act provides a period of 180 days to fill up this vacancy.

**Amendment**

A new sub-rule has been added to the Rule 4, which provides that the above given provisions will not be applicable to the following classes of unlisted public company:

a) A joint venture

b) A wholly owned subsidiary, and

c) A dormant company\(^2\) as defined under Section 455 of the 2013 Act.

**Amendment to Schedule IV - Code for independent directors**

Schedule IV to the 2013 Act includes a code for professional conduct of independent directors. It lays down the guidelines relating to the professional conduct, role and functions, duties of an independent director, their manner of appointment, reappointment, resignation or removal and an evaluation mechanism.

The table below provides an overview of the amendments made to certain paragraphs of Schedule IV to the 2013 Act:

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| **Paragraph III (sub-paragraph 12)** | Duties of independent directors: As per the current provisions, the independent directors should, *inter alia*, act within his/her authority and assist in protecting the legitimate interests of the company, shareholders and its employees.  
*Amendment*  
As per the amendment, independent directors should, *inter alia*, act *within their authority* and assist in protecting the legitimate interests of the company, shareholders and its employees.  
*(Emphasis added to highlight the change)* |
| **Paragraph VI (sub-paragraph 2)** | Resignation or removal: Currently, an independent director who has resigned or has been removed from the board of the company, should be replaced by a new independent director within a period of not more than 180 days from the date of such resignation or removal, as the case may be.  
*Amendment*  
As per the amendment, the new independent director should be appointed *within three months* from the date of such resignation or removal.  
*(Emphasis added to highlight the change)* |
| **Paragraph VII (sub-paragraph 1)** | Separate meetings: Independent directors of a company are required to hold at least one meeting in a year, without the attendance of non-independent directors and members of management.  
*Amendment*  
As per the amendment, at least one meeting of independent directors should be held in a *financial year*, without the attendance of non-independent directors and members of management.  
*(Emphasis added to highlight the change)* |
| **New note** | Certain exemptions given to government companies from the requirements of Schedule IV  
After paragraph VIII (evaluation mechanism) of the Schedule IV, a new note has been inserted which provides certain exemptions to a government company\(^3\) as defined under Section 2(45) of the 2013 Act. |

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\(^2\)A company which is formed and registered under the 2013 Act for a future project or to hold an asset or intellectual property and has no significant accounting transaction or an inactive company may make an application to the Registrar of Companies (ROC) in such manner as may be prescribed for obtaining the status of a dormant company.

\(^3\)Government company means any company in which not less than 51 per cent of the paid-up share capital is held by the CG, or by any state government or governments, or partly by the CG and partly by one or more state governments, and includes a company which is a subsidiary company of such a government company.
Paragraph Overview

New note

These exemptions are available to a government company if they are specified by the concerned ministries or departments of the Central Government (CG) or the state governments.

The requirements of Schedule IV that would not be applicable to government companies are as following:

a) Paragraph II (sub-paragraph (2) and (7)): Functions of an independent director:
   i. Bring an objective view in the evaluation of the performance of board and management and
   ii. Determine appropriate levels of remuneration of executive directors, Key Managerial Personnel (KMP) and senior management and has a prime role in appointing and where necessary recommend removal of executive directors, KMP and senior management.

b) Paragraph IV: The manner of appointment of an independent director.

c) Paragraph V: Reappointment of an independent director should be on the basis of report of performance evaluation.

d) Paragraph VII (clauses (a) and (b) of sub-paragraph (3)): The independent directors should review the following in its meeting:
   i. Performance of non-independent directors and the board as a whole and
   ii. Performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors.

e) Paragraph VIII: The performance evaluation of independent directors should be done by the entire board of directors, excluding the director being evaluated.

Further, whether to extend or continue the term of appointment of an independent director, should be determined on the basis of the report of performance evaluation.

(Source: KPMG in India’s analysis, 2017 based on the provisions of Schedule IV to the 2013 Act and MCA notification dated 5 July 2017)

Others

The MCA has also issued revised Form DIR-5 ‘Application for surrender of Director Identification Number (DIN)’. The additions made in the revised form vis-à-vis old form are as follows:

• Revised form requires furnishing of particulars of the applicant which includes the name of the applicant, relation with the DIN holder, DIN and Permanent Account Number (PAN) of the applicant.

• Following additional documentary proofs should be attached with the form:
   a) Affidavit including declaration to the fact that retained DIN will be updated with all associated Corporate Identification Number (CIN)/Limited Liability Partnership Identification Number (LLPIN),
   b) Copy of court order declaring DIN holder as insolvent/unsound mind
   c) Copy of death certificate.

• Declaration of the fact that the DIN holder has never been appointed as director/designated partner in any company/LLP and the said DIN has never been used for filing of any document with any authority is also required to be given.

Applicability

The amendments became applicable from the date of publication of the notifications in the official gazette i.e. 5 July 2017.

Our comments

Independent directors have been entrusted with various significant duties under the 2013 Act and accordingly, a separate code of conduct has been defined which is aimed at ensuring their professional conduct at all times. The MCA continues to monitor significant aspects related to the appointment and function of the independent directors and made certain amendments to the 2013 Act and the related Rules. Most of the amendments are in line with the recommendations made by the Company Law Committee (CLC) in its report dated 1 February 2016.
Our comments (cont.)

Some of the significant amendments made to the provisions governing independent directors are as follows:

- **Prescribed classes of companies not required to appoint independent directors on their board:** An unlisted company which is a joint venture, a wholly owned subsidiary or a dormant company is not required to appoint independent directors. This is a significant amendment that helps with the ease of doing business. The amendment was also recommended by the CLC.

- **Reappointment in case of removal or resignation:** Currently, a new independent director (in place of an independent director who has resigned or has been removed from the board of the company) is required to be appointed within a period of 180 days from the date of such removal or resignation as per Schedule IV to the 2013 Act.

  The MCA has reduced the time limit for appointment of a new independent director in such cases to three months. The amendment is in line with the recommendation made by the CLC which proposed to harmonise the provisions of the Schedule IV with that of the requirements of proviso to Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014 and Regulation 25(6) of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements), 2015. The proviso and the SEBI regulations prescribe that any intermittent vacancy of an independent director should be filled-up at the earliest but not later than the immediate next board meeting or three months from the date of such vacancy.

  Further, period of three months for appointment of a new independent director seems to be sufficient time and would also ensure that the board of the company should not be without an independent director for a longer period of time.

- **Meeting of independent director to be held in a financial year:** The MCA has provided that independent directors should hold at least one meeting in a financial year (earlier ‘year’ was mentioned). The amendment seeks to provide clarity to the companies that one meeting is required in a financial year, so that every financial year has one meeting at least. The amendment is also in line with the recommendation of the CLC.

The bottom line

Companies should take note of the amendments and ensure compliance with them for a better and transparent corporate governance.
The topics covered in this issue are:

• Business model analysis for loans and debt investments
• Key responsibilities of directors
• Application of substance over form under Ind AS – lease of land
• Deemed cost accounting under Ind AS
• Regulatory updates.

Missed an issue of Accounting and Auditing Update or First Notes

Issue no. 11/2017 – June 2017

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MCA issues further relaxations from certain provisions of the Companies Act, 2013

23 June 2017

The MCA through its notifications dated 13 June 2017 and 22 June 2017, provided further exceptions/modifications/adaptations to the provisions of the 2013 Act for the above mentioned class of companies (i.e. private companies, Section 8 companies and government companies).

These exceptions/modifications/adaptations would be available to the companies which have not defaulted in filing of its financial statements under Section 137 or annual return under Section 92 of the 2013 Act with the Registrar of Companies.

This issue of First Notes provides an overview of the exceptions/modifications/adaptations made to the 2013 Act for private companies, Section 8 companies and government companies.

Ind AS - Practical perspectives

KPMG in India’s Ind AS - Practical perspectives through aims to put a finger on the pulse of India Inc’s adoption of Ind AS and capture emerging trends and practices.

Our impact assessment is based on Nifty 50 companies which would be the first group of companies to report Ind AS results. The Nifty 50 companies have declared their financial results for the year ended 31 March 2017.

Out of the companies comprising Nifty 50 index, eight companies are banks, two are Non-Banking Financial Companies (NBFCs) and two companies follow a different date of transition to Ind AS. Therefore, our analysis would comprise the remaining 38 companies.

This can be accessed on KPMG in India website - ‘Ind AS- Practical perspectives’ webpage

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