"CRITICAL ANALYSIS OF: REGULATION OF COMPANY"

DISSERTATION

Submitted in the Partial Fulfilment for the Degree of

MASTER OF LAW'S (LL.M.)

SESSION: 2019-20

UNDER SUPERVISION OF:

TRISHLA SINGH

(Assistant professor)

School of Legal Studies, BBDU

SUBMITTED BY:

TRISHA SINGH

ROLL No.:1190990026

School of Legal Studies, BBDU

DECLARATION

Title of Project Report **Critical Analysis of: Regulation of Company.** I understand what plagiarism is and am aware of the University's policy in this regard. **TRISHA SINGH.**

I declare that

(a) The work submitted by me in partial fulfilment of the requirement for the award of degree **LLM** Assessment in this **DISSERTATION** is my own, it has not previously been presented for another assessment.

(b) I declare that this **DISSERTATION** is my original work. Wherever work from other source has been used, all debts (for words, data, arguments and ideas) have been appropriately acknowledged.

(c) I have not used this work previously produced by another student or any other person to submit it as my own.

(d) I have not permitted, and will not permit, anybody to copy my work with the purpose of passing it off as his or her own work.

(e) The work conforms to the guidelines for layout, content and style as set out in the Regulations and Guidelines.

Date : ………………

TRISHA SINGH

University Roll No. **1190990026**

(LL.M. (2019-20)

CERTIFICATE

This is to certify that the research work entitled **"Critical Analysis of: Regulation of Company"** is the work done by a student of Babu Banarasi Das University Lucknow, under my guidance and supervision for the partial fulfillment of the requirement for the Degree of **(LLM) in** Babu Banarasi Das University Lucknow, Uttar Pradesh. According to the best of my knowledge, he/she has fulfilled all the necessary requirements prescribed under the University Guideline with regard to the submission of this dissertation.

I wish him/her success in life.

Under the Guidance of

Date –

Trishla Singh

(Assistant Professor)

BABU BANARASI DAS UNIVERSITY

LUCKNOW

ACKNOWLEDGEMENT

I acknowledge the heartfelt thanks to the Institute of legal Studies, Babu Banarasi Das University Lucknow**,** for providing me the opportunity to complete my dissertation for the Partial Fulfillment of the Degree in (LLM).

I am thankful to my Supervisor **Miss. Trishla Singh (Assistant Professor),** for not only helping me to choose the dissertation topic but also for her valuable suggestions and co-operation till the completion of my dissertation. She provided me every possible opportunity and guidance and being a support in completing my work.

I also thank to all the respondents without whom this study would have never been completed.

I am thankful to everyone from core of my heart.

(**Trisha Singh**)

(LLM)

Roll No. 1190990026

Babu Banarasi Das University

Lucknow

LIST OF ABBRIVETION

A.I.R.	:	All India Reporter
SCC	:	Supreme court cases
H.C.C	:	High court cases
HC.	:	High court
SC	:	Supreme court
CAPT.	:	Captain
e.g.	:	Example
I.P.C.	:	Indian Penal Code
Prof.	:	Professor
S.	:	Section
U.S.A.	:	United States of America
V.	:	Versus
i.e,	:	That is
ART	:	Article

LIST OF CASES

- Bacha F. Guzdar V. CIT
- Central Urban Bank Ltd. V. Corporation of Madras
- Candler v. Crane Christmas and Co.
- Delhi V. State of Delhi
- Gallaghar V. Germania Brewing Company
- Hadley v. Baxendale
- H. S. Sidhana V. Rajesh Enterprises
- Indian Medical Association v. V. P. Shanthan
- India Ltd. V. G. C. Odusumathd
- Life Insurance Corporation of India V. Escorts Ltd.
- Lee V. Lee‘s Air Farming Ltd
- Minority v. majority and company v. stakeholders
- Solomon v. Solomon & Co. Ltd
- Solomon V. Solomon &Co. Ltd
- Typewriters Ltd. V. Stanley.

TABLE OF CONTENT

DECLARATION

CERTIFICATE

ACKNOWLEDGEMENT

LIST OF ABBRIVETION

LIST OF CASES

CHAPTER 1

Introduction

1.1 .1Definition of a Company

1.2 Statement of problem

1.3 Research Questions

1.4 Objective

1.5 Hypothesis

1.6 Scope and Limitations of Study

1.7 Research Methodology

1. 8 Significance of Study

1.9 Literature Review

CHAPTER 2

2.1 History of Company Legislation in India

CHAPTER - 3

Evolution of Company Law

CHAPTER 4

THE REGULATORY OF COMPANY AUDIT IN INDIA

4.1 Development of Company Audit Regulation in India

4.2 The Role of Ministry of Corporate Affairs (MCA)

4.3 Regulation of Audit by the Companies Act of 1956

5.5 The Professional Regulation

CHAPTER - 5

REGULATORY OF INDIAN STOCK MARKET

5.1 Companies Act, 1956

5.2 The Capital Issues (Control) Act, 1947

5.3 The Securities Contract (Regulation) Act, 1956

5.4 The Reserve Bank of India (RBI)

5.5 Securities and Exchanges Board of India (SEBI) Act, 199 2

5.6 SEBI Guidelines for Primary Market and Secondary Market

CHAPTER-6

LEGISLATIONS AND REGULATORY BODIES FOR PREVENTION OF CORPORATE FRAUDS IN INDIA

6.1 The Companies Act 2013

6.2 Security Exchange Board of India Act, 1992

6.3 The Depositories Act, 1996

6.4 The Securities Contract (Regulation) Act, 1956

CHAPTER

CONCLUSIONS AND SUGGESTIONS

BIBLIOGRAPHY

CHAPTER 1

Introduction

Company Legislation in India owes its origin to the English Company Law. The Companies Acts passed from time to time in India have been following the English Companies Acts, with certain modifications. Even the Companies Act, 1956, it is said, closely followed the U.K. Companies Act, 1948. In London, the earliest business associations during the 11th to 13th centuries were called the _merchant guilds‘. These guilds obtained charters from the Crown mainly to secure for their members, a monopoly in respect of particular trade or commodity. These associations were either formed a _Commenda‘ or _Societas‘. _Commenda‘ operated in the form of partnership, the financier being a sleeping partner with limited liability. The liability was basically borne by the working partners. In _Societas‘, on the other hand, all the members took part in the management of the trade and had unlimited liability, more in line with the present day partnership.

In the 14th century, the word _Company‘ was adopted by certain merchants for trading overseas. This was, more or less an extension of the merchant guilds in foreign trade. By the end of 16th century Royal Charters granted monopoly of trade to members of the Company over a certain territory. These companies were called regulated Companies. East India Company was one of such regulated companies established by a Charter in 1600. It had monopoly of trade in India; its members could carry on trade individually and had the option to subscribe to the joint fund or stock of the company. After such voyage, the profits made, together with the subscribed amount, were divided among the members. In 1653, however, a permanent subscribed fund was introduced, called joint fund or stock of the company. Accordingly, the term joint stock came into use. The profits were, however, shared at the end of each voyage. By the end of 17th century all these companies or merchant guilds any many regulated companies which the Crown had incorporated, meanwhile had established permanent fixed capitals represented by shares which were freely saleable and transferable. The property with which the companies treated was recognised as being under the exclusive control of their governors or directors for the purpose of carrying on these undertakings and was not available for division between members at intervals of time.

At this time the only method of obtaining the incorporation of a company was by Royal Charter or by an Act of Parliament. These methods of incorporation were quite expensive and time consuming. Consequently, many companies were formed by agreement without incorporation. As a result, the first 20 years of 18th Century witnessed a flood of speculative and often fraudulent schemes of company floatation's of which the notorious schemes of the South Sea Company is the best known example. The South Sea Company had a scheme to acquire virtually the whole of the national debt (approx. £ 31,000,000) by purchasing the holdings or exchanging the holdings for the stock of the company. The possession of interest- bearing loan owed by the State was a basis on which the company might raise vast sums to extend its trade. This theory was not necessarily unsoundit was indeed a logical extension of the principle upon which the Bank of England, and the South Sea Company itself, had been originally formed but unfortunately, the Company had very little trade to expand. It had paid a huge sum of money for obtaining the charter in competition with the Bank of England. Ultimately, the company failed. In 1720, the British Parliament came down heavily on such companies in order to check the orgy of speculation in shares and securities which had reached its heights. Consequently, the Bubble Act, 1720 was passed. The Act prohibited generally the use of the form of corporations unless a corporation was authorised to act as such by an Act of Parliament or Royal Charter. However, it exempted all undertakings operative especially before June 24, 1978. With the passing of the Act companies disappeared like the bursting of the bubble.

Although the Bubble Act held up the development of capital market for a century, it did not destroy the unincorporated company. To avoid the rigours of the Act, large partnerships were formed. The parties to the deed agreed to be associated with a joint fund or stock divided into number of transferable shares and agreed to alteration of the provisions of the deed by a specified majority. They delegated the management to the directors. The property was vested in a body of trustees which was also given powers to sue or be sued on behalf of the company.

In 1825, the Bubble Act was repealed. In 1834, the Trading Companies Act, 1834 was passed empowering the Crown to confer by Letters Patent any of the privileges of incorporation except limited liability, without actually granting a Charter. The Chartered Companies Act, 1837 re-enacted the Act of 1834 providing for the first time that personal liability of members might be expressly limited by the Letters Patent to a specified amount per share.

In 1844, the Joint Stock Companies Act was passed for the first time. This Act provided for the registration of Companies with more than 25 members or with shares transferable without the consent of all the members. It also provided for incorporation by registration. The Act for the first time created the office of the ―Registrar of Companies‖ and required particulars of the Company's constitution, changes therein and annual returns to be filed with the Registrar so that there would be full record retained officially

Limited liability, however, was still excluded. Although the company became incorporated, the personally liability of the members was preserved, but their liability was to cease three years after they had transferred their shares by registered transfer and creditors had to proceed first against the assets of the company. Members could only escape personal liability by providing in its contracts, as unincorporated companies had formerly done, that only the Company's property and the amount unpaid on its member's shares should be answerable in default. Such a provision was effective if inserted in the contract on which the plaintiff sued, but not, if it was merely contained in the Company's deed of settlement, even if the plaintiff knew of it when he contracted with the Company.

In 1855, however, an Act of Parliament was passed called Limited Liability Act, 1855 by which any company registered under the Act of 1844 might limit the liability of its members for its debts and obligations generally to the amount unpaid of their shares. The Act was repealed within a few months. In fact, the English Companies Act, 1856 known as the Joint Stock Companies Act, 1856 replaced both the Acts of 1844 and 1855. Under this Act, the company legislation assumed for the first time a form which has been broadly handed down almost to the present day, subject to various amendments which were made from time to time to suit various exigencies. Under this Act seven or more persons could form themselves into an incorporated company with or without limited liability by signing a memorandum of association and complying with the requirements of the Act. The Act of 1856, in its turn, was repealed by the Companies Act, 1862 which followed the same pattern but contained a number of improvements. The Companies Act, 1862 was amended by 17 later Acts, the most important of which enabled Companies to reduce their share capital to alter the objects which they were formed to carry out, imposed liability on promoters and directors for false statements inviting public subscription to shares and debentures, and introduced the concept of private company, which could be

incorporated with only two members. In 1908, the whole of the existing statute law was consolidated and after further amending statutes, in 1929 and 1948, the Companies Act of those years repealed the existing law and enacted new consolidated legislation. The Companies Act, 1948 was itself amended and supplemented by the Companies Acts of 1967, 1976, 1980, 1981 and 1983. In 1985, the whole of the existing statute law relating exclusively to companies was consolidated in the Companies Act, 1985 which is the present statute governing companies in England.

1.1 .1Definition of a Company

The Companies Act, 1956, does not define a company in terms of its features. Section 3 (1)(i) of the Act merely states that ―a company means a company formed and registered under this Act or an existing company as defined in Section 3(1)(ii).‖ Section 3(1) (ii) lays down that ―an existing company means a company formed and registered under any of the previous Company Law.‖ This definition does not clearly point out the meaning of a company. In order to understand the meaning of a company, let us see the definition as given by different authorities. Some of the definitions are:-

Lord Justice Lindley- ―A company is an association of many persons who contribute money or monies worth to a common stock and employed in some trade or business and who share the profit and loss arising there from. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute to it or to whom it pertains are members. The proportion of capital to which each member is entitled is his share. The shares are always transferable although the right to transfer is often more or less restricted.‖

Chief Justice Marshall a corporation is an artificial being, invisible, intangible, existing only in contemplation of the law. Being a mere creation of law, it possesses only the properties which the Charter of its creation confers upon it, either expressly or as incidental to its very existence.‖

Prof. Haneya company is an artificial person created by law, having separate entity, with a perpetual succession and common seal.‖

The above definitions clearly bring out the meaning of a company in terms of its features. A company to which the Companies Act applies comes into existence only when it is registered

under the Act. On registration, a company becomes a body corporate i.e. it acquires a legal personality of its own, separate and distinct from its members. A registered company is there created by law and law alone can regulate, modify or dissolve it.

1.2 Statement of problem

Even today, a vast majority of Indian businesses, including companies listed on the stock exchanges, has a concentrated ownership in the hands of family business groups. At times even where the controlling family may have only modest ownership control, companies in India remain family-managed and promoted[1].In the events of corporate frauds such as Satyam, it is not only public shareholders but also stakeholders such as employees, creditors, customers, industry as a whole that suffers. A crucial question in Indian context is regarding agency problem between minority-majority shareholder and that between the company and stakeholders other than shareholders. That independent director‘s holds solution to these agency problems especially in Indian model of closed ownership is a vital question.

1.3 Research Questions

Based on this hypothesis the following research questions have been formulated:

1) What theoretical basis were responsible for evolution of concept of independent directors in the country of its origin United States and other jurisdiction such as United Kingdom?

2) What role and functionality was entrusted to independent director‘s office in United States? How did judiciary respond to independent directors?

3) What is the scope and definition of independent directors in India?

4) What is the difference between corporate sector and governance models in India and United States?

5) Does Indian statute and regulatory bodies imbibe this concept and its role in clear and unambiguous terms?

[1] Id.

6) Is it possible to effectively expand and assign independent directors the task to ensure protection of interests of minority shareholders and stakeholders?

1.4 Objective

Amidst claims being made that independent directors, a transplanted concept, primarily meant to solve first level of agency problem i.e. the management shareholder conflicting interested, this study aims to decipher how far this concept can resolve other related agency problems. In the context of controlled or promoter-dominated firms in India, this study seek to explore what roles independent directors play at such firms where agency problems offer highly complex situation of minority v. majority and company v. stakeholders. Further in event of corporate frauds such as Satyam, how far independent directors and their functionality can avert such debacles in future or at least raise alarm for investors and regulators.

1.5 Hypothesis

This study is based on the hypothesis that solution to the minority-majority agency problem as well that between the company and stakeholders lies with independent directors. The scope and functions of independent directors in the Board of Directors can be effectively expanded in the statutory and regulatory framework to address the issues of not only minority shareholders against controlling shareholders but also for the other stakeholders.

1.6 Scope and Limitations of Study

The scope of this study is to thoroughly examine and understand the theoretical and historical background of the concept of independent directors and contextualise the same in the Indian scenario where insider model of governance dominates the corporate scene. The scope of research therefore extends to the country of origin United States and to some extent United Kingdom. In the process several significant provisions in relevant statues such as Sarbanes Oxley and committee reports have been studied. Also it is important to mention that the judicial response to independent directors especially the one of Delaware Court has been explored in greater details. This is primarily due to the reason that Delaware Corporate law and the state itself is considered to be amongst the most progressive and highly dynamic jurisdictions so far as company law in US is concerned. The adoption of this concept in India is largely routed through

several committee reports and recommendations and therefore a study of the same is made. Comparisons have been drawn between the erstwhile Company Act 1956 which has been replaced with the Company Act 2013 while this study was still going on. Importantly, Clause 49 of Listing Agreement of the Securities Exchange Board of India i.e., SEBI finds frequent reference.

While there has been tremendous amount of literature and empirical research for the value of independent directors, the same question is considered to be out of scope for this study. Similarly the difference between concepts of nonexecutive directors, outside directors has not been dealt with at greater length.

1.7 Research Methodology

This study adopts a doctrinal method and referred to several books, journals, committee reports, Ministry websites, judicial decisions etc. Further a comparative, historical, critical and analytical mode of exploration has been adopted.

1. 8 Significance of Study

There are lot of debates and deliberations throughout the different jurisdictions on the issue of independent directors. The study will help to understand the roles and responsibilities of the Independent Directors and their Impact on the Corporate World not only from the point of view of Indian Context but from the International Context too.

1.9 Literature Review

There exists a large body of literature that provides insight into historical evolution of company and its manner of functioning. Again there is no dearth of material about comparative company law, modes of governance. When it comes to independent directors a writings comprise of conceptual understanding, what is meant by independence, how one can ensure this independence, how one may differentiate independent directors from non-executive directors and so on. While on also comes across literature that has argued about whether or not independent directors are effective and what value, if at all, they bring to the Board and tested the same empirically as well; there is little that puts across how independent directors can also be an answer to stakeholders groups. Especially for country such as India which has family dominated

and insider model of corporation, how scope and functionality of independent directors can be extended to accommodate minority v. majority and company v. stakeholder conflict.

CHAPTER 2

2.1 History of Company Legislation in India

As noted in the initial paragraphs, the Company Legislation in India has closely followed the Company Legislation in England. The first legislative enactment for registration of Joint Stock Companies was passed in the year 1850 which was based on the English Companies Act, 1844. This Act recognised companies as distinct legal entities but did not introduce the concept of limited liability. The concept of limited liability, in India, was recognised for the first time by the Companies Act, 1857 closely following the English Companies Act, 1856 in this regard. The Act of 1857, however, kept the liability of the members of banking companies unlimited. It was only in 1858 that the limited liability concept was extended to banking companies also. Thereafter in 1866, the Companies Act, 1866 was passed for consolidating and amending the law relating to incorporation, regulation and winding-up of trading companies and other associations. This Act was based on the English Companies Act, 1862. The Act of 1866 was recast in 1882 to bring the Indian Company Law in conformity with the various amendments made to the English Companies Act of 1862. This Act continued till 1913 when it was replaced by the Companies Act, 1913. The Act of 1913 had been passed following the English Companies Consolidation Act, 1908. It may be noted that since the Indian Companies Acts closely followed the English Acts, the decisions of the English Courts under the English Company Law were also closely followed by the Indian Courts. Till 1956, the business companies in India were regulated by this Act of 1913. Certain amendments were, however, made in the years 1914, 1915, 1920, 1926, 1930 and 1932. The Act was extensively amended in 1936 on the lines of the English Companies Act, 1929. Minor amendments were made a number of times thereafter.

At the end of 1950, the Government of independent India appointed a Committee under the Chairmanship of H.C. Bhaba to go into the entire question of the revision of the Indian Companies Act, with particular reference to its bearing on the development of Indian trade and industry. This Committee examined a large number of witnesses in different part of the country and submitted its report in March 1952. Based largely on the recommendations of the Company Law Committee, a Bill to enact the present legislation, namely, the Companies Act, 1956 was introduced in Parliament. This Act, once again largely followed the English Companies Act,

1948. The major changes that the Indian Companies Act, 1956 introduced over and above the Act of 1913 related to: (a) the promotion and formation of companies;(b) capital structure of companies;(c) company meetings and procedures; (d) the presentation of company accounts, their audit, and the powers and duties of auditors; (e) the inspection and investigation of the affairs of the company; (f) the constitution of Board of Directors and the powers and duties of Directors, Managing Directors and Managers, and (h) the administration of Company Law.

The Companies Act, 1956 has been amended several times since then. The major amendments were introduced in the years 1960, 1962, 1963, 1964, 1965, 1966, 1967, 1969, 1974, 1977, 1985, 1988 and 1991.

In the wake of economic reforms processes initiated from July, 1991 onwards, the Government recognized the many provisions of the Companies Act had become anachronistic and were not conducive to the growth of the Indian corporate sector in the changing environment. Consequently, an attempt was made to recast the Act, which was reflected in the Companies Bill, 1993. The said Bill, however, was subsequently withdrawn. As part of continuing reforms process and in the wake of enactment of the Depositories Act, 1996, certain amendments were, however, incorporated by the Companies (Amendment) Act, 1996.

In the year 1996, a Working Group was constituted to rewrite the Companies Act, following an announcement made by then Union Minister for Finance in his Budget Speech to this effect. The main objective of the Group was to re-write the Act of facilitate healthy growth of Indian corporate sector under a liberalized, fast changing and highly competitive business environment. Based on the report prepared by the Working Group and taking into account the developments that had taken place in structure, administration and the regulatory framework the world over, the Companies Bill, 1997 was introduced in Rajya Sabha on August 14, 1997 to replace by repealing the Companies Act, 1956. In the meantime, as part of the reforms process and in view of the urgency felt by the Government, the President of India promulgated the Companies (Amendment) Ordinance, 1998 on October 31, 1998 which was later replaced by the Companies (Amendment) Act, 1999 to surge the capital market by boosting morale of national business houses besides encouraging FIIs as well as FDI in the country. The amendments brought about number of important changes in the Companies Act. These were in consonance with the then prevailing economic environment and to further Government policy of deregulation and

globalisation of the economy. The corporate sector was given the facility to buy-back company's own shares, provisions relating to the investments and loans were rationalized and liberalized besides the requirements of prior approval of the Central Government on investment decisions was dispensed with, and companies were allowed to issue — sweat equity‖ in lieu of intellectual property. In order to make accounts of Indian Companies compatible with international practices, the compliance of Indian Accounting Standards was made mandatory and provisions for setting up of National Committee on Accounting Standards was incorporated in the Act. For the benefit of investors, provisions were made for setting up of Investor Education and Protection Fund‖ besides introduction of facility of nomination to shareholders debenture holders etc[2].

The First Amendment of 2002 provides for producer companies. The Second Amendment of 2002 replaces the Company Law Board with National Company Law Tribunal and also creates an Appellate Tribunal. Apart from taking over the jurisdiction of the Company Law Board, the National Company Law Tribunal has been vested with the jurisdiction of the High Courts under the Companies Act. The result is that the jurisdiction of the High Courts has also become reduced to a very few points. Since this amendments has not been enforced, the original Act holds good[3].

Company

The word _Company' has no strictly technical or legal meaning Stanley, Re[4]. It may be described to imply an association of persons for some common object or objects. The purposes for which people may associate themselves are multifarious and include economic as well as non-economic objectives. But, in common parlance, the word _company' is normally reserved for those associated for economic purposes i.e. to carry on a business for gain.

Used in the aforesaid sense, the word _company', in simple terms, may be described to mean a voluntary associations of persons who have come together for carrying on some business and sharing the profits there from.

[2] Company Law and Practice by A. K. Majmudar and Dr. G.K. Kapoor Taxmann's Publication 15th Edition see pg. 1 to 5
[3] Company Law by Avtar Singh Publication Eastern Book Company, 15th Edition see pg.3
[4] [1906] 1Ch. 131

Indian Law provides two main types of organisations for such associations: _partnership‘ and _company‘. Although the word _company‘ is colloquially applied to both, the Statute regards companies and company law as distinct from partnerships and partnership law. Partnership law in India is codified in the Partnership Act, 1932 and is based on the law of agency, each partner becoming an agent of the others and it, therefore, affords a suitable framework for an association of a small body of persons having trust and confidence in each other. A more complicated form of association, with a large and fluctuating membership, requires a more elaborate organisation which ideally should confer corporate personality on the association, that is, should recognise that it constitutes a distinct legal person, subject to legal duties and entitled to legal rights separate from those of its members. This can be obtained easily and cheaply by registering an association as a company under the Companies Act, 1956[5].

1.2.1. Incorporated association

The company must be incorporated or registered under the Companies Act. Minimum number required for this purpose is seven in the case of a _public company‘ and two in case of a _private company i.e., Section 12. It may also be mentioned that an association of more than 10 persons in case of banking business and 20 persons in other commercial activities, if not registered as a company or under any other law, becomes an illegal association i.e., Section 11.

1.2.2. Legal entity distinct from its members

Unlike partnership, the company is distinct from the persons who constitute it. Hence, it is capable of enjoying rights and of being subjected to duties which are not the same as those enjoyed or borne by its members. As Lord Macnaughten puts it, ―the company is at law a different person altogether from the subscribers......; and though it may be that after incorporation the business is precisely the same as it was before and the same persons are managers and the same hands receive the proceeds, the company is not in law, the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act.‖ i.e., Solomon‘s case.

---

[5] Supra note 1 pg. 10

The first case on the subject even before the famous Solomon‘s case was that of Kondoli Tea Co. Ltd[6]. In this case certain persons transferred a tea estate to a company and claimed exemption from ad valorem duty on the ground that they themselves were the shareholders in the company and, therefore, it was nothing but a transfer from them in one to themselves under another name.

Rejecting this, the Calcutta High Court observed- ―The Company was a separate person, a separate body altogether from the shareholders and the transfer was as much conveyance, a transfer of the property, as if the shareholders had been totally different persons[7].‖

Even where a single shareholder virtually holds the entire share capital, a company is to be differentiated from such a shareholder. In the well known case of **Solomon v. Solomon & Co. Ltd**[8] Solomon was a prosperous leather merchant. He converted his business into a limited Company- Solomon & Co. Ltd. The Company so formed consisted of Solomon, his wife and five of his children as members. The company purchased the business of Solomon for £ 39,000 for purchase consideration was paid in terms of £10,000 debentures conferring a charge over the company‘s assets, £20,000 in fully paid £1 share each and the balance in cash. The company in less than one year ran into difficulties and liquidation proceedings commenced. The assets of the company were not even sufficient to discharge the debentures held entirely by Solomon himself. And nothing was left for the unsecured creditors. The House of Lords unanimously held that the company had been validly constituted, since the Act only required seven members holding at least one share each. It said nothing about their independent or that there should be anything like a balance of power in the Constitution of the company. Hence, the business belonged to the company and not to Solomon. Solomon was its agent. The company was not the agent of the Solomon.

Likewise, in the case of Lee V. Lee‘s Air Farming Ltd L formed a company with a share capital of three thousand pounds, of which 2999 pounds were held by _L‘. He was also the sole governing director. In his capacity as the controlling shareholder, _L‘ exercised full and unrestricted control over the affairs of the company. _L‘ was a qualified pilot also and was appointed as the chief pilot of the company under the articles and drew a salary for the same.

---

[6] Re ILR [1886]
[7] Supra note 1 pg 10- 11
[8] [1859-99] All.ER 33 (HL)

While piloting the company's plane he was killed in an accident. As the workers of the company were insured, workers were entitled for compensation on death or injury. The question was while holding the position of sole governing director could L also being an employee/ worker of the company. Held that the mere fact that someone was the director of the company was no impediment to his entering into a contract to serve the company. If the company has a legal entity, there was no reason to change the validity of any contractual obligations which were created between the company and the deceased. The contract could not be avoided merely because _L' was the agent of the company in its negotiations. Accordingly _L' was an employee of the company and, therefore, entitled to compensation claim.

So much so that even if a shareholder acquires all shares of a company, business of the company does not become his business unless the company is treated as his agent. **Gramophone & Typewriters Ltd. V. Stanley.**[9]

Even where a decree has been issued by the Court in respect of sums due against a company, the same cannot be enforced against its managing director. In **H. S. Sidhana V. Rajesh Enterprises**[10] it was held that the liability to discharge the decretal amount was that of the company and not of its managing director. The executing court could proceed against the managing director only if it came to the conclusion that the managing director was personally liable to discharge the decretal amount .

Again, in Chamundeeswari V. CTO, Vellore Rural1 it was held that a company being a legal entity by itself, any dues from company have to be recovered only from company and not from its directors.

1.2.3 Artificial person

The company, though a juristic person, does not possess the body of natural being. It exists only in contemplation of law. Being an artificial person, it has to depend upon natural persons, namely, the directors, officers, shareholders, etc., for getting its various works done. However, these individuals only represent the company and accordingly whatever they do within the scope

---

[9] [1908-10] All. ER 833 (CA)
[10] 0 [1993] 77 Comp. Cas. 251 (P&H)

of the authority conferred upon them and in the name and on behalf of the company, they bind the company and not themselves.

1.2.4 Limited Liability

One of the principal advantages of trading through the medium of a limited company is that the members of the company are only liable to contribute towards payment of its debt to a limited extent. If the company is limited by shares, the shareholder‘s liability to contribute is measured by the nominal value of the shares he holds, so that once he or someone who held the shares previously has paid the nominal value plus any premium agreed on when the shares were issued, he is no longer liable to contribute anything further. However, companies may be formed and unlimited liability of members or members may guarantee a particular amount. In such cases, liability of the members shall not be limited to the nominal or face value of their shares and the premium, if any, unpaid thereon. In the case of unlimited liability companies, member shall continue to be liable till each paisa has been paid off. In case of companies limited by guarantee, the liability of each member shall be determined by the guarantee amount, i.e., he shall be liable to contribute up to the amount guaranteed by him. If the guarantee company also has share capital, the liability of each member shall be determined in terms of not only the amount guaranteed but also the amount remaining unpaid on the shares held by a member.

If a company is unable to pay its debts, its creditors may petition the Court to wind it up. If a winding-up order is made, a liquidator is appointed to administer its affairs, and if he realises insufficient amount to pay its debt by selling its assets, he calls upon its shareholders to make good the deficiency, but, of course, their liability to do so is limited to the balance of capital unpaid on their shares plus unpaid premiums. It may be that some of the shareholders as at the date the winding-up commences are themselves insolvent and unable to contribute the balance of unpaid capital in respect of their shares. In that case, the liquidator can recover the unpaid capital from any person who held the shares in question within a year before the winding -up began.

1.2.5 Separate Property

Shareholders are not, in the eyes of the law, part owners of the undertaking. In India, this principle of separate property was best laid down by the **Supreme Court in Bacha F. Guzdar**

V. CIT.[11] The Supreme Court held that a shareholder is not the part owner of the company or its property, he is only given certain rights by law, for example, to vote or attend meetings, or to receive dividends.

1.2.6 Transferability of Shares

One particular reason for the popularity of joint stock companies has been that their shares are capable of being easily transferred. The Companies Act, 1956 in Section 82 echoes this feature by declaring ―the shares, debentures or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company‖. However, in case of private companies certain restrictions are placed on right of the member to transfer his shares.

1.2.7 Perpetual Succession

Company being an artificial person cannot be incapable by illness and it does not have an allotted span of life. Being distinct from the members, the death, insolvency or retirement of its members leaves the company unaffected. Members may come and go but the company can go for ever. It continues even if all its human members are dead. Even where during the war all the members of a private company, while in general meeting were killed by a bomb, the company survived.

1.2.8 Common Seal

A Company being an artificial person is not bestowed with a body of a natural being. Therefore, it does not have a mind or limbs of human being. It has to work through the agency of human beings, namely, the directors and other officers and employees of a company. But, it can be held bound by only those documents which bear its signature. Common seal is the official signature of a company[12].

---

[11] [1955]25 Comp. Cas.1 (SC)
[12] Supra note 1 pg.13-16

1.2.9 Lifting the Corporate Veil

The chief advantage of incorporation from which all others follow is, of course, the separate legal entity of the company. In reality, however, the business of the artificial person is always carried on by, and for the benefit of, some individuals. In the ultimate analysis, some human beings are the real beneficiaries of the corporate advantages, ―for while, by fiction of law, a corporation is a distinct entity yet in reality, it is an association of persons who are in fact the beneficiaries of the corporate property, **Gallaghar V. Germania Brewing Company**[13]. It may, therefore, happen that all the corporate personality of the company is used to commit frauds or improper or illegal acts. Since an artificial person is not capable of doing anything illegal or fraudulent, the facade of corporate personality might have to be removed to identify the persons who are really guilty. This is known as ‗lifting the corporate veil'. Although, in general, the courts do not interfere and essentially go by the principle of separate entity as laid down in the Solomon's case and endorsed in many others, it may be in the interest of the members in general or in public interest to identify and punish the persons who misuse the medium of corporate personality.

In Cotton Corporation of **India Ltd. V. G. C. Odusumathd**[14] the Karnataka High Court has held that the lifting of the corporate veil of a company as a rule is not permissible in law unless otherwise provided by clear words of the Statute or by very compelling reasons such as where fraud is needed to be prevented or trading with enemy company is sought to be defeated.

As to when the corporate veil shall be lifted, the observations of the Supreme Court in Life Insurance Corporation of India V. Escorts Ltd. is worth noting.―While it is firmly established ever since in Solomon V. Solomon &Co. Ltd[15]. that a company is an independent and legal personality distinct from the individuals who are its members, it has since been held that the corporate veil may be lifted, the corporate personality may be ignored and the individual members recognised for who they are in certain exceptional circumstances. Generally, and broadly speaking the corporate veil may be lifted where the statute itself contemplates lifting the veil or fraud or improper conduct is intended to be prevented, or a taxing statute or a beneficent

[13] [1893] 53 MINN. 214
[14] 5 [1999] 22 SCL 228 (Kar.)
[15] [1897] AC 22

statute is sought to be evaded or where associated companies are inextricably connected as to be, in reality, part of one concern[16].

1.2.10 Company vis-a-vis Body Corporate

Body Corporate means an association of persons which has been incorporated under some statute having perpetual succession, a common seal and having a legal entity different from the members constituting it. Sub-section (7) of section 2 of the Companies Act defines the expression _body corporate‘ as follows:

> Body corporate‘ or _corporation‘ includes a company incorporated outside India but does not include
>
> (a) A corporation sole; (b) a co-operative society registered under any law relating to co-operative societies; (c) any other body corporate not being a company which the Central Government may, by notification in the Official Gazette, specify in this behalf.‖

It will further include all public financial institutions mentioned in section 4A as well as the nationalised banks incorporated under section 3, sub section (4) of the Banking Companies (Acquisition & Transfer of Undertakings) Act.

It may be noted that under clause (c) of sub-section (7) of section 2, the Central Government has reserved the right to declare any association of persons as a body corporate. Accordingly, Oil & Natural Gas Commission (ONGC) was declared as a body corporate.

Thus, the word body corporate‘ is not equivalent to the words _incorporated company‘. An incorporated company is a body corporate but many bodies corporate are not incorporated companies- Madras **Central Urban Bank Ltd. V. Corporation of Madras**[17]. The expression _corporation‘ or _body corporate‘ is, thus, wider than the word company.

Is a Society registered under the Societies Registration Act, a body corporate?- A society registered under the Societies Registration Act has been held by the Supreme Court in **Board of Trustees Ayurvedic & Unani Tibia College, Delhi V. State of Delhi**[18] not to come within the

[16] Supra note 1 pg. 19-20
[17] [1932] 2 Comp. Cas. 328 (Mad.)
[18] AIR 1962 SC 458

term _body corporate�' under this Act, though such a society is a legal person capable of holding property and becoming a member of a company.

Similar view had been held by the Department of Company Law administration in its communication No. 8/26/2(7)/63/PR dated 13th June, 1962 addressed to Federation of Indian Chambers of Commerce. The Department observed as follows:

Generally speaking, this Department would consider that a body which has been or is incorporated under some statute and which has a perpetual succession and a common seal and is a legal entity apart from the members constituting it, will come within the definition of the term _body corporate‘. The term will not, however, include a society registered under the Societies Registration Act, 1860, or any of the bodies which have been specifically excluded by clauses (a), (b) or (c) of Section 2, sub-section (7).

A close scrutiny from the above characteristics of the company viz, Legal entity distinct from its members, separate property, artificial person, limited liability, separate property, transferability of shares, perpetual succession and common seal clearly indicates that company has a separate legal entity different from its owners and the same is managed by a set of people who are not owners. It is this separation of ownership and control that give significance to the role of Directors. The fact that managers of a company are not owners gave rise to possibilities where such managers may be either careless with other people‘s money or abuse power and position and information to further their own ends at cost of company or shareholders. To counterbalance such tendencies concept of independent directors came into existence.

The Board of Directors of any company is considered to be the principal authority for a company's governance, the structure and composition of the board would necessarily have an impact on the manner in which the company is governed. Among the various structural changes that have occurred in recent years to improve the way in which companies are governed, the introduction of the concept of an independent director occupies a prominent position. The rise of independent directors in a model of corporation where dispersed ownership dominates is conventionally understood to address management-shareholders agency problem. An active and independent board of directors working for shareholders clearly would seem to benefit the

corporation by reducing the losses from misdirected 'agency' inherent in the separation of ownership from control that is fundamental to the modern corporation[19].‖

Two models have been dominating the corporate governance in the worldOne, _outsider' model where companies are dispersedly held, commonly found in US, the worry is that the management of the firm may be able to expropriate assets of the shareholders or behave in an opportunistic or non-value maximizing manner. Second, _insider' model where companies have a controlling shareholder, the principal corporate law concern is that the controlling shareholder may have damaging tendencies to the minority shareholders. For instance, frauds like Enron and WorldCom where the management and frauds like Parmalat and Satyam where the controller attempted to misrepresent financial performance or cover up expropriation. Laxity of auditors and independent directors were found to be factors in all these instances. Thus, interestingly even where corporate governance models differ, corporate frauds have demonstrated some sort of converging norms.

The seminal work of Kraakman et al[20] identify three types of agency problems: (i) the conflict between managers-agent and owners, being shareholders-principal, (ii) the conflict between controlling shareholders -agent and minority shareholders- principal, and (iii) that between the company itself (agent) and other stakeholders with whom the company contracts, such as creditors, employees and customers-principal.

Considering the ownership structure of Indian firms, scholar Umakanth Varottil has comprehensively demonstrated that due to the concentrated ownership structures in Indian companies, it is the minority shareholders who require the protection of corporate governance norms from actions of the controlling shareholders. Board independence, in the form it originated, does not provide a solution to this problem. That the concept of independent directors evolved to solve first set of problem is beyond argument. However, present time concept of independent director may be extended to solve the third set of agency problem assumes criticality.

[19] Ira M. Millstein and Paul W. MacAvoy, The Active Board of Directors and Performance of the Large Publicly Traded Corporation, 98 COLUM. L. REV. 1283, 1291 (1998).
[20] Reinier R. Kraakman, Et Al., The Anatomy of Corporate Law: A Comparative and Functional Approach 22 (2004).

CHAPTER - 3

Evolution of Company Law

Corporations formed for the purpose of carrying on business have a long history. But it is only for the last about 125 years that the Legislature in England has made it easy for groups of persons to attain corporate form, and to trade with' limited liability, and it is only by reason of these two features that the company law both here and in England is regarded as one of the most important pieces of legislation today. The history of companies can be resolved into well-defined and distinct' periods. The earliest is one which preceded what is known as the Bubble Act of 1720. The idea of employing corporate bodies for the purpose oftrade was well known in the 17th century. There were great many companies carrying on the trade outside the British Islands and those companies were given a number of privileges by the British Government, both governmental and trading. One of such companies was the East India Company which started business in this country as far as back as in 1600 A.D. In curse of time, some of those companies became rulers of territories, and some of the other companies e.g. Virginia Company, disappeared when a settled colony was formed.

The Company legislation in India has closely followed the Company Legislation in England

The origin of company form of organization in England dates back to centuries and its glimpses can be traced from 11th century[21]. A century-wise discussion about the growth of Company law in England follows in the coming paragraphs:

- The earliest business associations in England during 11th to 13th Centuries were called the Merchant Guilds.
- Such Guilds which were prevalent in England obtained Charter from the King/Queen to establish a body corporate.
- The purpose of establishing such Guilds was to secure monopoly in a particular trade.

[21] Refer Chartered Secretary, January, 2006, published by ICS1, New Delhi, under the Article "Company Law in India is modeled on English provisions" by Dr. J. P. Sharma, FCS, Senior Faculty Member, Faculty of Commerce and Business, Delhi School of Economics, University ofDelhi.

• Gradually members of guilds started trading on joint account subject to Guilds rules.

11th to 13th Centuries - period of Merchant Guilds

. The earliest business associations in England during 11th to 13th Centuries were called the Merchant Guilds.

- Such Guilds which were prevalent in England obtained Charter from the King/Queen to establish a body corporate.
- The purpose of establishing such Guilds was to secure monopoly in a particular trade.
- Gradually members of guilds started trading on joint account subject to Guilds rules.

Types of Guilds

i. Commends

- Trader lent money to another and got share profit,
- Had limited liability to money financed,
- Lender was a sleeping partner,

ii. Societies

- All members took active part,
- Had unlimited liability,
- There was mutual agency on the lines of present day partnership

14th Century - Guilds extended to Foreign Trade

- By Royal Charter, such guilds were given special privileges
- The word "company" was adopted by some traders for trading with foreign countries.

16th Century - period of regulated Companies

- During this period joint trading started growing
- Separate trading or private trading bymembers ofGuilds/Joint Trading Companies was allowed.

- Such guilds were called Regulated Companies

17th Century - period of Joint Stock Companies

1600 - East India Company was established by the Royal Charter of Queen Elizabeth. The object was to share profits of each voyage from its monopoly trade in Far East.

The characteristics ofmodem corporate bodies were clearly visible in the constitution and working of East India Company. In the charter of the company were named a Governor of the company, who was not different from modem day chairman of the Board of Directors and several committee members equivalent of present day directors. The successors ofthe committee-men were to be elected annually by the shareholders.

The Governor and the committee-men were required to submit frequent reports on their important decisions for confirmation of General Courts of all subscribers ofthe company corresponding to the general meetings ofthe shareholders in the present day2. Companies during this period were called as Joint Stock Companies.

- 1670 - The Harts and Bay Company was founded by the Royal Charter.
- 1692 - Separate trading/private trading by members of East India Company was prohibited.
- 1694 - Bank ofEngland was founded by the Royal Charter.

18th Century -Enactment of the Bubble Act, 1719

- Bubble Act was passed in 1719. With the passing ofthis Act, companies disappeared like the bursting ofthe bubble.
- The Act prohibited formation ofJoint StockCompanies except by the Royal Charter.
- The aim was to place a check on the growth of unregistered companies.
- The Act had led to widespread panic amongst unregistered companies.

19th Century - Repealment of the Bubble Act

1825 - The Bubble Act was ultimately repealed

1844 - Enactment ofJoint Stock Companies Act, 1844

- First enactment to bear the title of "Joint Stock Companies Act".

- Provision for the registration of companies was there.
- The office ofthe Registrar ofJoint StockCompanies was created.

1855 - Limited Liability Act, 1855

- English Parliament in 1855 passed the Act providing for limited liability to the members ofa registered company.

1856 - Joint Stock Companies Act, 1856

- Act of 1844 was superseded by a comprehensive Act of 1856. This Act introduced the mode offormation of companies by Memorandum ofAssociation and Articles of Association.

1862 - Companies Act, 1862

- First enactment to bear the title "Companies Act".
- Memorandum and Articles were made compulsory

20th Century

1900 - Companies Act, 1900

- Compulsory audit ofthe company's accounts was enforced. 1908 – Companies Act, 1908
- It was called as Companies (Consolidation) Act, 1908
- The Concept of private company was introduced.

1948 - Companies Act, 1948

- It was the Principal Act in force in England.
- It was based on the report of a Committee under Lord Cohen
- New form ofcompany known as Exempt Private Company was introduced.
- Emphasis was on the public accountability ofthe company.
- Protection ofminority was the highlight.
- Investigation ofcompany's affairs were also incorporated.
- Shareholders in general meeting were given power to remove a director before the
- expiration of his period of office.

1967 - Companies (Amendment) Act, 1967

- It was based upon the Jenkins Committee recommendations presented in 1962.
- The Amendment Act abolished the concept of exempt private company.
- Stringent provisions were introduced in relation to.directors interests in the company and disclosures thereof.

1976 - Companies Act, 1976

• Strengthened the requirements of public accountability and relating to disclosures of interests in the shares ofthe company.

1980 - Companies Act, 1980:

- The Act was a major step towards company law reforms in UK.
- The Act fundamentally changed the structure of company law in England.
- Insider dealing was made a criminal offence.
- Shareholders were given a right of pre-emption in the case of new issues ofshares.
- Dealings between directors and their companies became greatly restricted and maximum financial limits were introduced for such dealings.

1981 - Companies Act, 1981

- For the purposes of accounting and disclosures, companies were divided as small, medium sized and other companies. Their disclosures requirements were differentiated accordingly.
- • Law relating to names of companies was simplified by the abolition ofthe approval of the name by the Department of Trade.
- • The Act further abolished the register of business names winch had to be kept under the Registration ofBusiness Names Act, 1916.
- Company was authorized to issue redeemable equity shares.
- Company was authorized to purchase its own shared.

1985-Companies Act, 1985

Whole of the then existing Statute relating exclusively to companies has been consolidated in the Companies Act, 1985.

The first legislative enactment for registration of Joint Stock Companies was passed in the year 1850 which was based on the English Companies Act, 1844.73A This Act recognized companies as legal distinct entities but did not introduce the concept of limited liability. The concept of limited liability, in India, was recognized for the first time by the Companies Act, 1857 closely following the English Companies Act, 1856 in this regard. The Act of 1857, however, kept the liability of members of banking companies unlimited. It was only in 1858 that the limited liability concept was extended to banking companies also. Thereafter in 1866, the Companies Act, 1866 was passed for consolidating and amending the law relating to incorporation, regulation and winding-up of trading companies an other associations. This Act was based on the English Companies Act, 1862. The Act of 1866 was recast in 1882 to bring the Indian Company law in conformity with the various amendments made to the English Companies Act of 1862. This Act continued till 1913 when it was replaced by the Companies Act, 1913. The Act of 1913 had been passed following the English Companies Consolidation Act, 1908. It may be noted that since the Indian Companies Acts closely followed the English Acts, the decisions of the English Courts under the English Company law were also closely followed by the Indian Courts. Till 1956, the companies in India were regulated by this Act of 1913. Certain amendments were, however, made in the years 1914, 1915,1920,1926,1930 and 1932. The Act was extensively amended in 1936 on the lines of the English Companies Act, 1929. Minor amendments were made a number oftimes.

At the end of 1950, the Government of independent India appointed a Committee under the Chairmanship of Shri H.C. Bhaba to go into entire question ofthe revision of the Indian trade and industry. This Committee examined a large number of witnesses in different parts ofthe country and submitted its report in March 1952. Based largely on the recommendations of the Company Law Committee, a Bill to enact the present legislation namely the Companies Act, 1956 was introduced in Parliament. This Act, once again largely followed the English Companies Act, 1948. The major changes that the Indian Companies Act, 1956 introduced over and above the Act of 1913 related to: (a) the promotion and formation of companies; (b) capital structure of

companies; (c) company meetings and procedures; (d) the presentation of company accounts, their audit and the powers and duties of auditors; (e) the inspection and investigation ofthe affairs of the company ; (f) the constitution of Board of Directors and the powers and duties of Directors, Managing Directors and Managers and (g) the administration of Company Law. The Companies Act, 1956 has been amended several times since then. The major amendments were introduced in the years 1960, 1962, 1963, 1964, 1965, 1966, 1967, 1969, 1974, 1977, 1985, 1988, 1991.

In the wake of economic reforms process initiated from July, 1991 onwards, the Government recognized that many provisions of the Companies Act had become anachronistic and were not conducive to the growth of the Indian corporate sector in the changing environment. Consequently, an attempt was made to recast the Act, which was reflected in the Companies Bill, 1993. The said Bill, however, was subsequently withdrawn. As part of continuing reforms process and in the Wake of enactment of the Depositories Act, 1996, certain amendments were, however,incorporated by the Companies (Amendment) Act, 1996.

In the year 1996, a Working Group was constituted to rewrite the Companies Act, following an announcement made by then Union Minister for Finance in his Budget Speech to this effect.

The Companies (Amendment) Act, 2000

The year 2000, witnessed another bouquet of amendments in order to provide certain measures of good corporate governance and for ensuring meaningful shareholders' democracy in the working of companies.

Accordingly, it introduced certain far-reaching changes and new concepts. These include:

1. Minimum Paid-up Capital Requirement'. All companies other than associations not for profit are required to have a minimum paid-up capital. Private Companies, since 13-12-2000, cannot be registered with less than Rs. 1,00,000/- paid-up capital and Public companies must have a minimum paid-up capital of Rs. 5,00,000/-.
2. Small Depositor. In order to grant protection to small depositors, sections 53AA and 58AAA were introduced. Provisions are designed to protect depositors who have invested up to Rs. 20,000 in a financial year in a company.

3. ShelfProspectus Information Memorandum andRed-herring Prospectus:

Financial institutions and banks have to make repeated offers of securities in a year may, instead of issuing Prospectus, issue a ‘Shelf Prospectus’ which will have a shelf like of one year. For any changes in between an ‘Information Memorandum’ containing those changes duly classified under appropriate heads need only be issued. Section 60A is designed to offer comfort to such institutions and also help reduce cost of issue.

Information Memorandum, as contemplated in section 60B is an attempt to recognize the book-building process (allowed under SEBI Guidelines since 1997). Information Memorandum is essentially a document designed to elicit demand for the securities and to ascertain the price and terms ofthe issue. It’s a necessary ingredient of book building processes.

‘Red-herring Prospectus' is an incomplete prospectus. It does not contain information regarding price and quantum ofsecurities.

4. Non-Voting Equity Shares: Section 86 was amended to allow issue of non-voting equity shares by public companies.
5. Passing of Resolutions through Postal Ballot: In order to encourage wider participation of shareholders, section 192A has been introduced to allow members / shareholders to vote on a particular resolution through postal ballot. Through Rules made by the Central Government, postal ballot has been mandatory for certain matters. Assent or Dissent to a resolution is required to be sent within 30 days.
6. Directors’ Responsibility Statement: Directors’ Report is to include a responsibility statement with respect to the following matters:

(i) whether accounting standards had been followed in the preparation of annual accounts and reasons for material departures, ifany;

(ii) whether appropriate accounting policies have been applied and on consistent basis;

(iii) whether directors had made judgments and estimates that are reasonable and prudent so as to give a true and fair view ofthe state of affairs and profit and loss of the company;

(iv) 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 ofthe company and preventing and detecting fraud and other irregularities;

(v) whether the directors had prepared the annual accounts on a going concern basis.

7. Audit Committees: New section, viz., 292A provides for constitution of audit committees by every public company having a paid-up capital of Rs. 5 crores or more. Audit Committee is to consist of at least 3 directors. Two-thirds of the members of the Audit Committee shall be directors other than managing or wholetime director.

   Recommendations of the Audit Committee on any matter relating to financial management including audit report shall be binding on the Board.

8. 'Secretarial Audit: Section 383A was amended to provide for secretarial audit with respect to companies having a paid-up share capital of Rs.10 lakhs or more but less than, presently, Rs.2 crores. A whole-time company secretary has to file with ROC a certificate as to whether the company has complied with all the provisions ofthe Act. A copy ofthis certificate shall also be attached with the Report of Board of Directors.
9. Issue ofIndian Depository Receipts: Section 605A permits companies incorporated outside India, whether having a place of business in India or not, to issue Depository Receipts in India and thus raise capital funds from Indian public.

Companies (Amendment) Act, 2001

amended provisions of section 11A relating to buy-back of shares allowing Board of Directors (instead of through special resolution) to buy-back shares up to 10% of the paid-up capital and free reserves provided not more than one such buy-back is made during a period of 365 days. Resolution for the aforesaid buy-back shall be required to be passed at a meeting of the Board and not through circulation.

Companies (Amendment) Act, 2002

Two Companies (Amendment) Acts were passed in December, 2002. These are called Companies (Amendment) Act, 2002 and Companies (Second Amendment) Act, 2002. The Companies (Amendment) Act, 2002 provides for setting-up and regulation of cooperatives as body corporates under the Companies Act, 1956 to be called 'Producer Companies'. The objective of the Companies (Second Amendment) Act, 2002 is to expedite the winding-up process of the companies, facilitate rehabilitation of sick companies and protection of workers interest. The,Second Amendment Act proposes to rationalize the procedure relating to winding up so that resources can be utilized for better purposes rather than blocking them in sick undertakings and thus, help in reducing the hardships to workers and other interested parties.

The Second Amendment Act provides for repeal of Sick Companies Special Provisions Act (SICA) and dissolution of Board of Financial Reconstruction (BIFR). At the same time, it seeks to establish a National Company Law Tribunal (NCLT) providing it with powers for expediting the winding up procedure.

The Application of Companies Act, 1956[22]

The Act applies to the following companies:

1) Companies formed and registered under the Act;
2) Every existing company (S.561);
3) Every company registered but not formed under any previous companies law to the extent and in the manner declared in Part IX ofthe Act(S.562);
4) Unlimited companies registered as limited companies in pursuance of any previous company law (S.563);
5) Companies registered under the Act pursuant to the provisions contained in Part IX of the Act to the extent specified in S.578;
6) Unregistered companies for the purpose of winding up under Part X under the Act. Section 582 defines an unregistered company of purposes ofthis Part and

[22] Shah, Aswin Lalubhai, "Lectures on Company Law" published in Oct 1980 at pg. 15 - 23 .

Section 589 prescribe the extent of its application commutatively with other provisions ofthe Act regarding winding up of companies formed and registered under the Act;

7) Foreign companies which comply with the provisipns of Section 592 ofthe Act;
8) Insurance companies except in so far as the provisions of the Act are inconsistent with the provisions ofthe Insurance Act, 1938 (IV ofJ938);
9) Banking companies except in so far as the provisions ofthe Act are inconsistent with those ofthe Banking Companies Act, 1949 (X of 1949);
10) Companies engaged in the generation or supply of electricity, except in so far as the provisions of the Act are inconsistent with the provisions of those contained in such special Act;
11) Any other company governed by any special Act for the time being in force, which the Central Government may, by notification in the Official Gazette, specify in this behalf subject to such exceptions, modifications, or adaptations as may be specified therein.
12) Such body corporate incorporated by any Act for the time being in force, which the Central Government may, by notification in the Official Gazette, specified in this behalf subject to such exceptions, modifications*, or adaptations as may be specified therein.
13) (The last five classes of companies are mentioned in Section 616 ofthe Act, and the last ofthem having been included by the Amendment Act, 1974).
14) Government Companies in which not less than 51 percent of paid-up share capital is held by the Central Government or by any State Government or partly by the State or partly by the Central Government and subsidiaries of such companies (S.617), subject to such exceptions, modifications and adaptations of the provisions of the Act (other than Ss.618, 619 and 619A) as may be specified by the Central Government by notification published in the Official Gazette [Section 620(l)(b)], and
15) Nidhis and Mutual Benefit Societies declared as such by the Central Government by notification in the Official Gazette, subject to such exceptions,

modifications and adaptations as may be specified in the notification[Section 620A(2)(b)j.

On the other hand, the Act does not apply to:

(1) Companies described in clause (13) above to the gxtent ofsuch provisions ofthe Act (other than Sections 618,618 and 619A) as may be likewise notified by the Central Government [Sec.620(l)(a)j;

(2) Nidhis and Mutual Benefit Societies aforesaid to the extent of such provisions of the Act as may be notified by the Central Government in the Official Gazette [Sec.620 A(2)(a)]; and (3) Companies of which winding up has commenced before the commencement of the Act, so far as the provisions ofthe Act relating to the winding up ofthe companies [other than Sec:555(7)] are concerned (Sec.647).

Jurisdiction of the Courts

Section 2(11) ofthe Act defines "Court" to mean, with respect to the matters relating to a company (other than any office against the Act), the court having jurisdiction under the Act with respect to that matter as provided in Section 10 and with respect to any offence against the Act, the Court of a Magistrate of a First Class, as the case may be, a Presidency Magistrate, having jurisdiction to try such offence. Section 10 of the Act provides that the Court having jurisdiction to deal matters arising under the Act shall be the High Court having jurisdiction in relation to the place at which the registered office of the company concerned is situate. The Central Government may, however, by notification in the Official Gazette, empower any District Court subordinate to such High Court to exercise all or any of the jurisdiction conferred by the Act upon the Court in regard to matters falling within the scope ofthe jurisdiction it is empowered to exercise, in the respect of companies having their registered office in the district. In such acase the High Court is not competent to exercise its jurisdiction but the District Court alone will deal with the matters falling within its jurisdiction.

CHAPTER 4

THE REGULATORY OF COMPANY AUDIT IN INDIA

4.1 Development of Company Audit Regulation in India

The Preamble to the Constitution of India guarantees all Indian citizens economic justice. All forms of regulations imposed on corporate accounting and accountancy profession in India may be construed to have derived from their origin of this provision of the Constitution. But the fact is that India has been regulating her company audit for the last 150 years or so. Prior to the Sepoy Mutiny of 1857, regulation by outside agency or through legislation of the corporate sector had no place in India. In the year of Sepoy Mutiny, the British Government started to rule India directly through the Queen's proclamation of 1857. The British Parliament had passed the first Indian Joint Stock Companies Act of 1857, modeled on the British Pattern. In fact a series of corporate legislations commencing in the year of 1857 gradually developed to meet the need of the changing society, and in time incorporated requirements that the stewardship accounts should be subjected to examination by statutory auditors. The 1857 Act, in its Table A contained provisions, the adoption of which was entirely optional, for annual audit of company accounts. In 1866, another Companies Act was passed. Subsequently, the Companies Act of 1882 replaced the Act of 1866 and remained in force for more than three decades. The 1882 Act contained two principal requirements. These were: (a) in every report, the auditor shall state whether in their opinion, the balance sheet is a full and fair one containing particulars required by the regulations and properly drawn up so as to exhibit a 'true and fair view' of the state of affairs...(Clause 94); and (b) every auditor shall be supplied with a copy of balance sheet and it shall be his duty to examine the same with the accounts and vouchers thereto (Clause 92) (Baneijee, 2002). In the first quarter of the twentieth century, the Companies Act of 1913 was passed and replaced the Act of 1882. The 1913 Act, remained in force for four decades or so and made first time the audit of company accounts compulsory. The requisite qualifications of the auditor, his powers and duties, and the procedure for appointment were laid down in the Act. Section 144 of the Act required only a person holding a certificate from local government or a member of an association or institute recognized for this purpose could act as an auditor. An important feature of the Act of 1913 was that an auditor's report was required to state whether or not the balance sheet was

drawn up in conformity with the law, and whether or not the balance sheet exhibited a "true and correct view" of the state of company's affairs etc. (Section 145(2)). In 1936, the Act of 1913 was revised thoroughly and amended. It required that an auditor's report shall state in addition, whether or not books of accounts have been kept as required by section 130 (Section 145(2)) (Banerjee, 2002).

Since independence India followed a mixed economic path of development with a tilt towards a controlled economy. But it was fact that before 1951, industrial securities as a form of savings were not popular in the country. The principal cause was the general distrust of public of private business. A gross mismanagement of corporate houses had undermined the confidence of investing people. As a result, drastic reforms were carried out to prop up investors confidence by the adoption of a series oflegislative codes namely, the Capital Issues (Control) Act, 1947 the Chartered Accountants Act, 1949 (henceforth the (CA Act) the Companies Act, 1956; the Securities Contracts (Regulation) Act, 1956; the Monopolies and Restrictive Trade Practices Act, 1969 (MRTP Act); and the Foreign Exchange Regulation Act, 1973. The Companies Act of 1956 (henceforth "the Companies Act") was enacted with the object to consolidate and amend the law relating to companies and certain other associations.

And the Companies Act of 1913 then in force was repealed. The Companies Act provides the basic requirements relating to financial reporting and auditing of all companies incorporated in India. The Companies Act has been amended on numerous occasions. The Act was amended through successive amendments Acts in the pre-reforms period viz., in 1960, 1965, 1974, and in 1988 and in the post-reforms period viz., in 1999, 2000, 2002 and 2006. Apart from the Companies Act, the CA Act has a direct concern in regulating the quality and contents of company audit in India. The Securities and Exchange Board of India (SEBI) Act of 1992, to a lesser extent, also regulates company audit in India. The underlying objectives of all these Acts are the protection of the interests of prospective shareholders and other stakeholders of the companies through statutory audits and corporate governance process. Note that the Comptroller

and Auditor General **(C&AG)**[23] of India is entrusted with the audit of government account and to appoint auditor for government **companies**[24] **in** the country.

Since the enactment of the Companies Act many changes have taken place in the national and international economic environment. This has made the economy more diverse, complex and dynamic. In this milieu, the corporate form of organization is increasing day by day. It is emerging as the preferred vehicle for economic growth of the Indian economy. The number of companies has expanded from 30,000 in 1956 to nearly 8 lakh companies operating as of December 2010. In 2003, there were over 9500 listed companies and 23 registered stock exchanges in India. Since 1999, total market capitalization has ranged from 22 to 25 percent of GDP (World Bank, 2004). Keeping in view the expansion and exponential growth of her economy and recognizing the effect of globalization of the day, the Ministry of Corporate Affairs (MCA, earlier DCA), Government of India has considered it desirable and appropriate to have a new regulatory regime for Indian corporate sectors. In this endeavour the MCA released in August 4 2004, a "Concept Paper on new Company Law". The MCA had also constituted a Committee on Company Law under the Chairmanship of Dr. J.J. Irani on December 2 2004 to revise the existing Companies Act of 1956. The Committee submitted its report on May 31 2005 (Irani Committee, 2005). Afterwards, the Government took up the exercise of comprehensive review of the Companies Act. The new Companies Bill of 2008 was introduced in the 14th Lok Sabha on October 23 2008. But it was lapsed since the 14th Lok Sabha was dissolved. The Bill was reintroduced as the Companies Bill of 2009. After Satyam fiasco, the Bill was further revised. The latest legislation on the anvil is the Companies Bill of 2011. The Union Cabinet of the 15the Lok Sabha on November 24 2011 has approved the Bill of 2011. The Bill is waiting for the approval of the both the Houses of Parliament and the assent of the President ofIndia. Now we provide an overview of the role of the MCA.

[23] The Constitution of India (1950) gave an independent status and special powers to the C&AG of India, who was entrusted to audit the transactions of government accounts. For this purpose the Comptroller and Auditor General (Duties, Powers and Conditions of Service) Act of 1971 was passed to regulate the duties and powers of C&AG.

[24] Government company means any company in which not less than fifty-one percent of the paid up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments and includes a company which is a subsidiary of a Government company as thus defined (Section 617 ofthe Companies Act).

4.2 The Role of Ministry of Corporate Affairs (MCA)

The MCA regulates all the companies registered in India as per the Companies Act of 1956 (henceforth the Act). The MCA is preparing ground for Indian corporate sector to play global. It is concerned with administration of the Act, other allied Acts and rules framed thereunder mainly for regulating the functioning of the corporate sector in accordance with law. The MCA is also responsible for administering the Competition Act of 2002 which will eventually replace the Monopolies and Restrictive Trade Practices Act of 1969 (MRRTP Act) under which the Monopolies and Restrictive Trade Practices Commission is functioning. It also exercises the supervision over the three professional bodies in the country: Institute of Chartered Accountants of India (ICAI), the Institute of Cost and Works Accountants of India (ICWAI) and the Institute of Company Secretaries of India (ICSI) which are constituted by three separate Acts of the Indian Parliament for proper and orderly growth of the professions concerned. The MCA has issued, from time to time, orders to plug the emerging loopholes in the Companies Act in order to enhance audit quality and strengthen corporate financial reporting framework. After Satyam scam, the MCA is now taking a re-look at creating more stringent rules to plug the loopholes in the Act through the new Companies Bill of 2011. The MCA has the following major affiliated offices. The power to implement penalties, notices, sanctions etc. are delegated to the bodies contained in the Companies Act.

4.1.1 Company Law Board (CLB)

The Central Government in terms of Section 10(E) of the Act constituted an independent Company Law Board in May 31, 1991. The CLB is an independent quasi-judicial body, exercising equitable jurisdiction, which was earlier being exercised by the High Court or the Central Government. It has powers to regulate its own procedures ordinarily the cases of oppression and mismanagement filed with it when the investigation revealed fraudulent acts committed by the management of companies. It has framed "Company Law Board Regulations 1991" prescribing the procedure for filing the applications/petitions before it.

4.1.2 Registrar of Companies (ROCs)

The Registrars of Companies (ROCs) appointed under Section 609 of the Act are vested with the primary duty of registering companies and ensuring that such companies comply with legislative

requirements under this Act. The Company law violations are looked into by the ROCs. In cases of allegations including financial implications, scrutiny is taken up by the ROCs under Section 234 of the Act for logical conclusions. The ROCs initiate necessary legal actions / prosecutions against the errant companies. But this function is hampered by severe lack of capacity in terms of trained manpower, thus, restricting oversight to listed companies (World Bank, 2004). The Central Government exercises administrative control over these offices through the respective Regional Directors (RDs). The Companies Bill in its Clause[25] (5) proposes to enhance powers ofthe ROCs.

4.1.3 Serious Fraud Investigation Office (SFIO)

The Serious Fraud Investigation Office (SFIO) is a multi-disciplinary organization under MCA, consisting of experts in the field of accountancy, forensic auditing, information technology, investigation, law, capital market and taxation for detecting and prosecuting whitecollar frauds. The Government of India has set up the SFIO in the MCA, with effect from July 1 2003, with a view to undertaking investigations under the provisions of the Act into corporate frauds. In cases, where wider public interest and serious allegations are involved, inspections under Section 209A or investigation under Section 235 or Section 237 of the Act are carried out by the S1FO for prosecutions for violations of the Act and the Indian penal Code of 1860. The Companies Bill in its Clause 211 (1) proposes the statutory status to the SFIO. Currently, the SFIO investigates serious cases offraud received from MCA.

4.1.4 Competition Commission of India (CCI)

The Competition Commission of India (CCI) is an affiliated office to the MCA. In order to create and sustain fair competition in the country, the Government of India enacted the Competition Act of 2002, amended in 2007. The objectives of the Act are sought to be achieved through the CCI (effective October 14 2003).

[25] Sub-sections (LA) & (4A) of Section 227 of the Act were inserted by the Companies (Amendment) Act of 1965. These insertions were the outcome of the Report of the Vivian Bose Commission (1963), constituted in 1956 to inquire into the administration ofIndia's nine Dalmia-Jain Companies.

4.1.5 Indian Institute of Corporate Affairs (IICA)

The Indian Institute of Corporate Affairs (IICA) was registered as a Society on September 12 2008, established by the MCA for capacity building and training in various subjects relevant to corporate laws and governance. It was set up by a team of administrators, experts and young professionals under the guidance of MCA and the Board of Governors.

4.3 Regulation of Audit by the Companies Act of 1956

The company's auditor is the lead actor on the disclosure front of corporate financial reporting. This is recognised in corporate legislations of all countries. India is no exception. This section discusses the company audit requirements. In India, the audit of company accounts is obligatory by the Companies Act of 1956 (henceforth the Act). The principal requirement of company accounts (Sections 209 to 223, 615 & 581ZE, 619A, Schedule V, VI & XIV) from which the company audit has emerged.

- The Board of directors (BoD) of every company requires to lay before the shareholders of the company at the annual general meeting (AGM), an audited balance sheet and a profit and loss account for the financial year (Section 210) while the balance sheet and profit and loss account will exhibit "true and fair view" of the state of affairs etc. of the company (Section 211). 50
- The Act requires that
- The Act requires that the profit and loss account shall be annexed to the balance sheet and the auditor's report (including the auditor's separate, special or supplementary report, if any) shall be attached thereto (Section 216).
- Balance sheet, profit and loss account, auditor's report and directors' report of the subsidiary company to be attached to the balance sheet of the holding company (Section 212)

(1) Appointment and Re-appointment of Auditors

The Act lays down requirements for appointments and reappointments of company auditors. The principal requirements are provided below.

- The first auditor or auditors of a company shall be appointed by the Board of directors ("the BoD") within one month of the date of registration of the company. The auditor so appointed shall hold office until the conclusion of the first annual general meeting (AGM) ofthe company.
- If the BoD fails to exercise its powers, the company in general meeting may appoint the first auditor (Section 224 (5).
- Every company shall, at each AGM, appoint an auditor or auditors to hold office from the conclusion of that meeting until the conclusion ofthe next AGM (Section 224 (1).
- Every auditor appointed shall within thirty days of the receipt from the company of intimation of his appointment, inform the Registrar in writing that he has accepted/refused to accept the appointment (Section 224 (1A).
- The BoD may fill any casual vacancy in the office of an auditor (Section 224 (6) (a). A casual vacancy may be created due to death, disqualifications of auditors.
- Where a casual vacancy is created by the "resignation of an auditor", the vacancy shall only be filled by the company in its general meeting. Any auditor appointed in a casual vacancy shall hold office until the conclusion ofthe next AGM (Section 224(6) (b).
- Section 224 (2) provides that subject to the provisions of 224(1B) and Section 224A, at any AGM, a retiring auditor, shall be re-appointed, subject to certain conditions (discussed inSection 7.1, Chapter Seven).
- Section 224A (1) of the Act lays down requirements for appointment of company auditors by special resolution (discussed in Section 7.1, Chapter Seven).
- Section 224 (3) requires that where at an AGM no auditors are appointed or re-appointed, the Central Government may appoint a person to fill the vacancy.
- Where auditors are not appointed or reappointed at an AGM as per Sections 225 (provisions as to resolutions for appointment or removal of auditors (discussed in Section
- 7.1, Chapter Seven); Section 190 (resolution requiring special notice); or Section 188 (circulation of members' resolutions) ofthe Act the Central Government shall be eligible to appoint the auditor.
- Section 225 lays down requirements for appointment of new auditors in place of a retiring auditor (discussed in Section 7.1, Chapter Seven).

- The auditor of a Government company shall be appointed or reappointed by the C&AG (Section 619 (2). The limits specified in Section 224(IB) & (IC) shall also apply in relation to the appointment or reappointment of an auditor under this Section 619(2).

(2) Tenure ofAppointment ofAuditors

- Every company shall, at each AGM, appoint auditors to hold office form the conclusion of that meeting until the conclusion ofthe next AGM (Section 224 (1).
- Ifthe AGM is not held in accordance with Section 166 ofthe Act, the auditor will continue to hold office till the AGM is held (discussed in Section 7.1, Chapter Seven).

(3) Ceiling on Number of Audits

The Act provides rules for ceiling on number of company audits that an auditor can hold. The requirements ofthe Act towards ceiling on numbers of audit are stated below.

- An auditor cannot hold more than the specified number of company audits i.e., twenty companies. Out ofthese twenty companies not more than ten shall have a paid-up capital of Rs. twenty five lakhs or more (Section 224 (IB).
- The method of calculation ofspecified numbers is contained in Section 224 (IC). It requires a chartered accountant (CA) in practice, can audit up to twenty companies out of which not more than ten shall have a paid up share capital of rupees twenty five lakhs or more. In the case offirm of auditors, the specified number should be computed per partner who is not in whole-time employment elsewhere.
- In computing the specified number, where a person or a firm is appointed as joint auditor shall be taken into account. Non-profit companies and companies limited by guarantee, etc are also to be taken into account in computing the specified number.
- Branch audit, special audit under Section 233A of the Act, investigation and audit of corporations set up under a separate Act are not to be counted for this purpose. Audits of foreign and private companies are not to be included within the specified number.
- While the Act excludes private companies the ICAI restricts the overall ceiling to thirty companies including private companies (discussed in Section 7.1, Chapter Seven).

(4) Fixation of Remuneration of Auditors

The principal requirements in relation to the remuneration of company auditors are discussed in brief.

The BoD of the company can fix the remuneration of the first auditors or auditors appointed by it to fill a casual vacancy in the office of auditors (Section 224 (8)).

- When the Central Government appoints auditors they can fix auditor's remuneration ifthey appoint auditors.
- When auditors are appointed by shareholders in general meeting the remuneration shall be fixed by at its general meeting.
- Appointment of auditor by the CA &G as per Section 619 of the Act the remuneration of such auditor shall be fixed by the company at its general meeting.
- Any sums paid by the company in respect of the auditors' expenses shall be deemed to be included in the expression "remuneration".

(5) Removal ofAuditors

The Act lays down requirements in its Section 224 through 225 to regulate unjustified removal of company auditors. The requirements will be presented in Chapter Seven (please see Section 7.1).

(6) Qualifications and Disqualifications of Auditors

The Act provides requirements for the qualifications and disqualifications of company auditors in its Section 226. The principal requirements are summed up as follows.

- According to Section 226 (1) a chartered accountant (CA) within the meaning of the CA Act is qualified for appointment as auditor of a company.
- A firm, whereof all the partners are practicing CAs in India are qualified for appointment auditor of a company by its firm name.
- The holder of a certificate granted under a law in force in the whole or in any portion of a Part B State immediately before the commencement of the Part B States (Laws) Act,

1951 or of the Jammu and Kashmir (Extension of Laws) Act, as the case may be, shall be entitled to be appointed as an auditor of companies (Section 226 (2) (a).

- Sections 226 (3) & (4) provides the auditor disqualifications (discussed in Section 7.1, Chapter Seven).
- Section 226(5) states that if an auditor becomes subject, after his appointment, to any of these disqualifications, he shall be deemed to have vacated his office as such.

(7) Rights or Powers of Auditors

The Act lays down provisions regarding the rights of company auditors. The principal requirements in relation to rights of company auditor are discussed in brief.

- Section 227 of the Act lays down provisions for rights of company auditors including access to books and vouchers, right to obtain information and explanations, right to visit Branch Offices (BO) etc. (discussed in Section 7.1, Chapter Seven).
- Where a company has BO, the accounts of that office shall be audited by the company's auditor or by a person qualified for appointment as company auditor under Section 226(Section 228 (1).
- Where the BO is situated outside India, either by the company's auditor or a person qualified as aforesaid to act as an auditor of the BO in accordance with the laws of the concerned country (Section 228 (1).
- Where the accounts of any BO are audited by a person other than the company's auditor, the company auditor: (a) shall be entitled to visit the BO; and (b) shall have a right of access at all times to the books and accounts and vouchers of the company at the BO (Section 228 (2).
- Section 228 (3) (b) provides that the person so appointed shall have the same powers and duties in respect of audit ofthe BO as the company's auditor has in respect of the same.

(11) Audit of Companies Incorporated outside India

Section 594 requires that every company incorporated outside India and having an established place of business in India, has to make out in every calendar year, a balance sheet and a profit and loss account in the same manner as is required of the companies incorporated under the Act,

and the balance sheet and profit and loss account should be audited by such persons and in such manner as laid down in the Act for companies incorporated in India.

(12) Liabilities of Auditors

Auditors are members of the accounting profession. It is expected that they shall carry out their professional work with due care and diligence. In Indian Medical Association v. V. P. Shanthan case of 1996, the Supreme Court has held that the practitioner must bring to his task a reasonable degree of skill and knowledge and must exercise a reasonable degree of care (Gupta, 2005). If the auditor fails to perform his professional duties properly he exposes himself to different types of liabilities. The liabilities of company auditor fall into four broad categories viz., (a) civil liabilities, (b) specific statutory liabilities, (c) criminal liabilities under the Indian Penal Code, and (d) professional misconduct and liabilities under the CA Act. The CA Act, specifies a number of acts and omission that constitute professional misconduct in relation to CAs in practice. Some professional misconduct requirements will be discussed in Chapter Seven. The civil and specific statutory liabilities under the Act are discussed here.

Civil Liabilities

Civil liabilities of company auditor may be of two types- damages for negligence and liability for misfeasance. According to The Webster's Encyclopedic Unabridged Dictionary of the English Language of 1994 edition, the term "misfeasance" means "the wrongful performance of a normally lawful act" or "the wrongful and injurious exercise of lawful authority" and the term "negligence" means "the failure to exercise that degree of care which, under the circumstances, the law requires for the protection of other persons or those interests of other persons which may be injuriously affected by the want ofsuch care."

Civil proceedings can be instituted against company auditors for damages occasioned by negligent discharge of their professional duties. A company auditor is presumed to bring reasonable care, skill, and diligence to bear upon the task which he is appointed to perform. If an auditor guilty of negligence in the execution of his professional duties and responsibilities with a "standard of care" or "due care" he / she may be held liable to make good damage resulting from that negligence. Either in the absence of requisite professional skill or failure to exercise it, an auditor will be held responsible for damages for negligence. A company auditor is liable to the

body of its shareholders albeit he owes no duty to individual shareholders. An auditor also owes duty of care to third party i.e., tax authorities, banks, and others. Many recent judgments in the UK, the USA and elsewhere show that the auditor cannot escape liability to third parties in all circumstances. This supports Lord Denning's viewpoint. Denning, in Candler v. Crane Christmas and Co. of1951 opined that an auditor had social responsibilities; the interpretation oflaw should not be so narrow and ridden with legal cliches as to deny social justice or equity. Denning'sjudgment was upheld in Hedley Byrne and Co. Ltd. (1964) (Gupta, 2005). Many recent research works reveal that the value of external audit in the US is demonstrated to include two important things: (a) assurance value, assuring that material misstatements are omitted from the audited financial reports; and (b) insurance value, providing compensations for investors if they incur investment losses due to misrepresentations in the audited financial reports (Menon and Williams, 1994; Baber et al. 1995) as Sami, and Ye (2005) mentioned. However, a company auditor may be called upon to pay compensation to their clients or third parties when they have suffered losses due to their negligence of duties. Damages for negligence under a contract or under tort are compensatory in nature and must arise in the usual course of things. In **Hadley v. Baxendale** (1845) the principles of awarding damages have been laid down by the Court of Exchequer. The principles of damages have been enunciated in the Indian Contract Act of 1872 in Section 73. In many cases damages were claimed from the auditors for alleged negligence of duties viz., in London and General Bank Ltd. (1895); **Kingston Cotton Mills Co. Ltd. (1896); and Irish Woolen Co Ltd. v. Tyson and Others (1900).**

Specific Statutory Liabilities

Specific statutory liabilities of auditor may be discussed from three specific legislative codes viz., the Companies Act, the Income-tax Act of 1961, and the Consumer Protection Act of 1986. We only discuss requirements of the Companies Act where the company auditors attract both civil and criminal liabilities. These liabilities are discussed in brief.

5.5 The Professional Regulation

This section discusses the requirements concerning company audit contained in the professional regulations in India. Before going to discuss it we give a brief account of the development of accounting profession in India. The Indian accounting profession began its history with the

enactment of the Indian Companies Act of 1857 that introduced for the first time the concept of preparing company balance sheet on a voluntary basis. Thereafter the Companies Act of 1913 made audit of company accounts compulsory and laid down requirements for the first time, the auditor's qualification, his powers and duties, etc. Restricted Certificate programme, entitling a person to act as auditor throughout British India, was started in the year 1913. The Government of Bombay started a training programme and an examination for accountancy profession, called Government Diploma in Accountancy (GDA) and an article-ship of three years in 1918. In 1920, the issue of Restricted Certificates was discontinued. In 1927 the Society of Auditors was founded in Madras (now Chennai). In 1930, the control over accountants in practice was shifted from provincial government to Central Government in order to maintain a uniform set of standards through out the country. The Central Government started maintaining a Register of Accountants (RA). In 1932, the Indian Accountancy Board (LAB) was constituted to advise it on matters relating to professional accounting. The first examination by the IAB was held in 1933. In 1943, GDA was abolished. But as professional accountants in India grew in numbers and importance, the demand for an autonomous body to regulate the accountancy profession grew stronger. For the purpose, an Expert Committee was formed in 1948 to examine the scheme of an autonomous association of accounting in India. It resulted, the Government ofIndia, in May 1 1949, enacted the Chartered Accountants Act of 1949 (effective on July 1 1949). The CA Act provides a basic framework for audit profession in India. The Institute of Chartered Accountants of India (ICAI) as a statutory body was established under the CA Act. The Government of India through the CA Act has given official recognition to individuals and members of the ICAI to carry out company audit in India. In India, there are two other legislative codes related to company accounts, audit, and governance. These two laws are the Cost and Works Accountants Act enacted in 1959 and the Company Secretaries Act enacted in 1980. These two Acts are exercised through the Institute of Cost and Works Accountants of India (ICWAI) and the Institute of Company Secretaries ofIndia (ICSI) have governance structures and power akin to the ICAI. The role of the ICAI is of particular importance because it has direct involvement in the company audits in India.

4.5.1 Role of the Institute of Chartered Accountants of India (ICAI)

The affairs of the ICAI are managed by the Council of the ICAI in accordance with the CA Act and the Chartered Accountants Regulations of 1988. The ICAI regulates the accountancy profession in the country, and in line with India's imperial history, was initially modelled on the ICAEW. The ICAI has been a founding member of the IFAC. The ICAI has been the founder member of the International Accounting Standard Board (IASB), the South Asian Federation of Accountants (SAFA), and the Confederation of Asian and Pacific Accountants (CAPA). It has also become a founder member of the International Innovation Network (IIN). It is the second largest accountancy body in the world next only to the American Institute of Certified Public Accountants (AICPA). The Council of the ICAI functions through its various Standing Committees viz., Disciplinary Committee, Executive Committee and various Non-Standing Committees viz., the Accounting Standards Board (ASB), Auditing and Assurance Standards Board (AASB), Ethical Standards Board (ESB), Peer Review Board (PRB) and Financial Reporting Review Board (FRRB). It recommends the accounting standards to. be followed by companies in India to the National Advisory Committee on Accounting Standards (NACAS)6. The ICAI is the only licensing cum regulating body of audit and accountancy profession in India. The ICAI sets the accounting and the auditing standards to be followed by practising CAs in the financial statements audit. It has taken numerous steps to ensure that its members discharge their duties with due professional care, competence and sincerity. It has stipulated a Code of Ethics for their members which provides basic framework for maintaining auditor independence. All the members of the ICAI are subject to this Code and several other pronouncements issued by the ICAI, violation of which is subject to disciplinary action. The ICAI issued the first Code of Ethics in November, 1963 and has revised it several times. The eleventh and last revision was made in January 2009. The ESB has revised its Frequently Asked Questions (FAQs) on Ethical Issues of 2004, released in February 2012. To address auditor independence, the ICAI has issued Guidance Note on Independence ofAuditors (revised) in January 21 2005 (issued first in 1968) (ICAI, 2010b) and taken some self-regulatory measures keeping in consideration the conflict of interest and duties of auditor. The ICAI issued first the Chartered Accountants Regulations in 1964, and was amended in 1988. In July 2002, the ICAI constituted the FRRB with a view to bring an overall improvement in the quality of services being rendered by the members of the profession, hi September 2002, the ICAI set up a Committee on Ethical Standards and

Unjustified Removal of Auditors (CESURA). The ICAI introduced a mandatory requirement for continuing professional education (CPE), effective from January 1, 2003. In order to examine various ethical issues, the ICAI set up an ESB in December 2008. As a measure of monitoring and improving the quality auditing, the ICAI has introduced the concept of "peer review" and constituted a PRB in April 2002. In February 2010, ICAI has formed a committee under the nomenclature Committee for Capacity Building of CA Firms and Small & Medium Practitioners (CCBCAF & SMP). In October 2011, it has issued three Corporate Affairs Standards (CASs) to guide the members and other stakeholders: Business Valuation; Auditors' appointment, retirement and removal; and Certification under MCA-21. However, the pronouncements issued by the ICAI may be classified into two broad categories- (1) accounting standards and quality control and engagement standards, and (2) authority attached to documents. These pronouncements are discussed below.

Accounting Standards and Quality Control and Engagement Standards

The accounting and auditing standards, issued by the ICAI establishes standards which have to be complied with to ensure that financial statements are prepared in accordance with generally accepted accounting standards and that auditors carry out their audits in accordance with the generally accepted auditing practices (ICAI, 2009). These are discussed below.

(1) Accounting Standards

Accounting standards (ASs) are accounting guidelines to specific issues in financial accounting and reporting (Porwal, 2001). The British introduced the term "standard" first in accounting literature when they set up the Accounting Standards Steering Committee (ASSC) in 1969. The Americans adopted it in 1973, when they set up the FASB with the winding up of Accounting Principles Board (APB). India used "standard" in April 21 1977 with the formation of Accounting Standards Board (ASB) by the ICAI. In view of acquiring the membership of the IASC (now IASB) in 1976, the ICAI constituted the ASB in 1977 to formulate accounting standards in India. The ASB issued first the "Preface to the Statements ofAccounting Standards " in January 1979 and AS 1: Disclosure of Accounting Policies in November 1979. Prior to the constitution of the NACAS by the Central Government in 1998, the ICAI was the sole accounting standard setter in India. While discharging attest functions, the members of the ICAI

may keep in mind with regard to the mandatory ASs. As per Section 227(3)(d) of the Companies Act company auditor is to report whether the profit and loss and account and balance sheet of the company complied with ASs, referred to in Section 211(3C) of this Act. The compliance of ASs issued by ICAI has become a statutory requirement with the notification of Companies (Accounting Standards) Rules of 2006 by the Government. Recognising the need of single set of globally accepted ASs, in 2006 the ASB took initiation for the convergence of the Indian ASs with the IFRSs of the IASB. The ASB finalized all Indian Accounting Standards (Ind ASs) corresponding to IFRSs and sent to the NACAS with a view to achieve convergence with IFRSs. The Companies Bill in its Clause 132 proposes to constitute the National Financial Reporting Authority (NFRA) to ensure monitoring and compliance of accounting and auditing standards in the Indian corporate sector.

Quality Control and Engagement Standards

In 1982, the ICAI constituted Auditing Practices Committee (APC) to review the existing auditing practices in India and to develop Statements on Standards Auditing Practices. Since the formation of the APC, the ICAI has been issuing Statements on Standards Auditing Practices (SAPs). The APC issued first the “Preface to the Statements on Standard Auditing Practices” in 1983 and SAP 1: Baisc Principles Governing an Audit in 1985. From July 2002, SAPs were renamed as Auditing and Assurance Standards (AASs) and the APC was renamed as the Auditing and Assurance Standards Board (AASB). The main function ofthe AASB is to review the existing auditing practices worldwide and identify areas in which standards on quality control, engagement standards and statements on auditing are in need of developing. The AASB revised its “Preface to the Statements on Standard Auditing Practices” in 2007 which was issued in 1983. As the ICAI is a member of the IFAC, the AASB has completed the mammoth task of revising the entire suit of its SAs in line with the ISAs of the IAASB of the IFAC under their Clarity Project. Till June 2011, the AASB of the ICAI has issued one Standard on Quality Control and 43 Engagement Standards including 35 Standards on Auditing (SAs) under Clarity Project which meet the international benchmarks and expectations. The new Standards issued by the AASB are collectively known as “Engagement Standards. These Standards comprise: SAs, SREs, SAEs, and SRSs, and a mother Standard on Quality Control. These are discussed below.

Standards on Auditing (SAs)

SAs are formulated in the context of audit of financial statements by an independent auditor. They are to be adapted as necessary in the circumstances when applied to audits of other historical financial information. The authority of SAs is set out in SA 200 (Revised) (ICAI, 2010c). SAs are divided into seven categories based on the aspect of audit engagement addressed by them and each of these categories has a unique numerical series allotted. The auditor complies with the requirements of SAs in all cases where they are relevant in the circumstances of audit (ICAI, 2009).

Standards on Review Engagements (SREs)

SREs are to be applied in the review of historical financial information. There are two SREs - SRE 2400 (Revised) (ICAI, 2010i) and SRE 2410 (ICAI, 2010j). The purpose of SRE 2400 is to establish standards and provide guidance on the practitioner's professional responsibilities when a practitioner, who is not the auditor of an entity, undertakes an engagement to review financial statements and on the form and content of the report that the auditor issues in connection with such a review. SRE 2410 requires that the auditor who is engaged to perform a review of interim financial information should perform the review in accordance with this SRE. Both SRE 2400 (Revised) and SRE 2410 require that the practitioner should comply with the Code ofEthics issued by the ICAI (ICAI, 2010).

Standards on Assurance Engagements (SAEs)

SAEs are to be applied in assurance engagements, and engagements dealing with subject matters other than historical financial information. SAE 3400 (ICAI, 2007d) should be read in the context of the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services". The purpose of SAE is to establish standards and provide guidance on engagements to examine and report on prospective financial information including examination procedures for best-estimate and hypothetical assumptions (ICAI, 2010).

Standards on Related Services (SRSs)

SRSs are to be applied to engagements involving application of agreed-upon procedures to information, compilation engagement, and other related services engagements, as may be

specified by the ICAI. There are two SRSs - SRS 4400 and SRS 4410. These standards should be read in the context of the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services". SRS 4400 (ICAI, 2004) provides guidance on the auditor's professional responsibilities when an engagement to perform agreedupon procedures regarding financial information is undertaken. SRS 4410 (ICAI, 2004a) establishes standards on the auditor's professional responsibilities when an engagement to compile financial statements or other financial information is undertaken etc. (ICAI, 2010).

Standard on Quality Control (SQC)

SQC is to be applied for all services covered by SAs, SREs, SAEs, and SRSs. The AASB published SQC 1 in October 2007, effective for all engagements on and from April 1 2009 (ICAI, 2007a). The purpose of this SQC is to establish standards and guidance regarding a firm's responsibilities for its system of quality control for audits and reviews of historical financial information, and for other assurance and related services engagements (ICAI, 2010). Besides, there is SA 220 (Revised) (ICAI, 2010d) which establishes standards and provides guidance on quality control procedures for audits of historical financial information.

Authority Attached to Documents

The members of the ICAI have sought guidance regarding the level of authority attached to various documents issued by the ICAI and the degree of compliance required in respect thereof (ICAI, 2009). The authority attached to documents ofthe ICAI mainly includes statements and guidance notes. These are discussed in brief.

Statements

The Statements have been issued with a view to securing compliance by members on - matters which, in the opinion ofthe Council ofthe ICAI, are critical for the proper discharge of their functions. "Statements" are, therefore, mandatory. In the event of any deviation from the "Statements", it will be their duty to make adequate disclosures in their audit reports. If a member has not been able to perform an audit in accordance with such "Statements" his report should draw attention to the material departures there from (ICAI, 2009). Two principal Statements issued by the ICAI are in force: (1) Statement on Reporting under Section 227 (1A)

of the Companies Act!, 1956 and (2) Statement on the Companies (Auditor's Report) Order, 2003 (revised 2005)(ICAI, 2009)

Guidance Notes

The Guidance Notes (GNs) are primarily designed to provide guidance to members of the Institute on matters which may arise in the course of their professional work and on which they may desire assistance in resolving issues which may pose difficulty. The GNs are recommendatory in nature. While discharging his attest function, a member should examine whether or not the recommendations in a GN relating to an accounting matter have been followed or not. If the same have not been followed, the member should consider keeping in view the circumstances of the case, disclosure in his report is necessary (ICAI, 2009). There are 28 GNs, issued by the ICAI of which some are mandatory and relevant to company audit. For examples, Guidance Note on Independence of Auditors (issued in 1968) revised in 2005; Guidance Note on Certification on Corporate Governance, revised in 2006 (ICAI, 2010b). These two GNs are related to company auditor and his independence.

4.6 The Stock Exchange Regulation

There are two main pieces of legislative codes governing the securities market in India - the Securities Contracts (Regulation) (SCR) Act of 1956 and the Securities and Exchange Board of India (SEBI) Act of 1992. The SCR Act was enacted in order to prevent undesirable transactions in securities by regulating the business dealing therein, and by providing for certain other matters connected therewith. India adopted a new Industrial Policy in 1991 in order to liberalize her economy. As an emerging economy, India continues to pursue business reform and diversification since the adoption of new industrial policy. The securities market in India has been one of the most significant institutional developments after launching of the new industrial policy. The need of the growing securities market was focused on having an integrated regulatory framework and its administration by an independent body. At that juncture, the motto was the protection of investors' rights and interests. Consequently, the Capital Issues (Control) Act of 1947 was repealed in 1992 and the office of the Controller of Capital Issues was abolished. The SCR Act was inadequate in the context of liberalization. Thus, the Central Government was enacted the SEBI Act on January 30 1992. The SEBI Act gave the SEBI

statutory recognition which was set up in April 1988. Let the role of the SEBI be explained in brief.

The Role ofthe Securities and Exchange Board ofIndia (SEBI)

The SEBI, a body corporate having perpetual succession and a common seal, was created on the blueprint of the US SEC. It is the corporate watchdog which regulates and supervises the securities market in India. The basic objectives of the SEBI are: (a) to protect the interests of investors in securities; (b) to promote the development of securities market; and (c) to regulate the securities market and for matters connected therewith or incidental thereto. The SEBI exercises its powers under the SEBI Act, the SCR Act, the Depositories Act of 1996, and the delegated powers under the Companies Act. For greater part, the SEBI regulations, guidelines and schemes are designed to ensure that the listed companies are within the parameters of the law. But the SEBI does not proactively monitor compliance with the accounting and disclosure requirements, which are unlike the US SEC and AISC of Australia etc. It only looks at company's financial statements contained in the prospectus ofthe company at the time of public offerings or in the case of complaints against listed companies. It refers cases of non-compliance of related requirements, if any, to the relevant Stock Exchange, the ICAI, and the MCA, as applicable. In order to make regulations more effective, the SEBI is contemplating to promote self-regulatory organisations (SROs) in Indian capital markets. It has framed the SEBI (SelfRegulatory Organisations) Regulations of 2003.

SEBI Clause 49-Corproate Governance

To protect the interest of investors, the SEBI has issued Clause 49-Corproate Governance, in October 29 2004. This guideline makes harsher the audit process of listed company with a mandate of audit committee formation (dealt with in Chapter Seven). The SEBI issued further two circulars. One issued on 31.12. 2005 and the other on 13.01.2006 in order to ensure compliance with the revised Clause 49 as well as some clarification to remove certain operational difficulties. The SEBI (vide circular SEBI/CFD/DIL/CG/1/2008/08/04) amended Clause 49 of the Listing Agreement. It goes without saying that inclusion of "corporate governance report" in the annual report of companies enhances the quality of corporate reporting

and auditing practices. Audit, in fact, is a key part of corporate governance. The auditor sees the company's approach to risk and challenges and management's judgment on the financials .

SEBI Disclosure & Investor Protection Guidelines

With the abolition of the Office of the Controller of Capital Issues (CCI) in 1992, the SEBI has got the power to vet companies' prospectus. It issued Disclosure & Investor Protection (DIP) Guidelines on June 11 1992 aims to secure fuller disclosure of relevant information about the issuer so that investing people can take informed decisions. It issued SEBI (Disclosure & Investor Protection) Guidelines, 2000 provided norms relating to eligibility for companies issuing securities, pricing of issues, listing of agreements, etc. Recently, the SEBI has framed the SEBI (Issue of Capital and Disclosure Requirements) Regulations of 2009 (notified on August 26 2009). So far as the disclosure part is concerned, company auditor plays a significant role as the report of the auditor of company forms an important part of the contents of "prospectus" as prescribed by the Schedule II of the Companies Act of 1956. Therefore, the SEBI protects market investors in several ways.

Therefore, the regulatory framework of company audit in India comprises a matrix of legislations including company law, professional law and rules of professional conduct, and securities laws. Company auditors in India are required to comply with these laws/regulations during an independent statutory audit .

CHAPTER - 5

REGULATORY OF INDIAN STOCK MARKET

The growth of security market of a country is influenced by the legislative measures taken by that country from time to time. The policy change has great impact on the minds of public which ultimately affects their saving habits. For effective mobilization of funds, it is necessary that the interest of the potential investors should be protected adequately.

In the pre-independence, the earliest legislation relating to stock market was introduced in the 19* Century. This legislation was passed in 1865 but it lost its impact due to outbreak of the American Civil War. Thereafter, the Atly Stock Exchange Enquiry Committee was set-up in 1923. This committee in its report, emphasized on necessity of the Stock Exchanges' framing and maintaining a systematic set of rules and regulations in the interest of the general investing public and of the trade itself. The next step towards special legislation for controlling stock markets was Bombay Securities Contracts Control Act, 1925. This Act gave certain powers to government in regard to recognition of Stock exchanges etc. but this act proved ineffective-in regulating security trading and government control there under was nominal, practically. The Bombay Security Contracts Control Act remained in force till the Securities Contract (Regulation) Act, 1956 enacted by the Central Government. The main Acts which effect the Securities markets are Companies Act, 1956, Capital Issues Control Act, 1947, Securities Contract (Regulation) Act, 1956, Securities Contract (Regulation) Rules 1957 and Securities and Exchange Board of India Act, 1992, which was set up as a Securities and Exchange Board of India (SEBI) on April 1988. It took almost four years for the government to bring about a separate legislation in the name of Securities and Exchange Board of India Act, 1992 conferring statutory powers. The Act charged to SEBl with comprehensive powers over practically all aspects of capital market operations. The Securities and Exchange Board of India (SEBI), has emerged as an important constituent of the system that now exists to regulate, control and monitor the Indian Financial System (IFS) as certain powers of some other constituents of this system have been delegated to the SEBl[26].

---

[26] V. A. Avadhani, "Investment and Securities in India", Himalaya Publishing House, Mumbai, 2007, pp. 51-54.

5.1 Companies Act, 1956

After Independence, the Government of India passed various legislations so that investors can have confidence while investing their savings. With a view to protect the interest of a large number of shareholders and creditors on healthy lines and to help the attainment of the ultimate ends of social and economic policy of the Government, the Companies Act, 1956 was passed. It was not enacted purely from legalistic point of view but it was also passed on the changing social needs of the country.

The Companies Act, 1956 which together with its amendments, is the substantive law in our country today and contains a large number of new and startling provisions for public control over the functioning of joint stock companies. The following are the basic objectives of the Companies Act, 1956:

(a) Minimum assured standard of business integrity and conduct in the promotion and management of companies;
(b) Full and fair disclosure of all reasonable information relating to the affairs of the company;
(c) Effective participation and control by shareholders and the protection of their legitimate interests;
(d) Enforcement of proper performance of their duties by the company management; and
(e) Power of intervention and investigation into the affairs of companies when they are managed in a manner prejudicial to the interest of the shareholders or to the public interest.

A company has to operate with in the legal framework prevailing in the country. The Companies Act deals with the formation and management of new companies. With the growth of joint stock companies, the capital market has taken a new turn in the development of the country[27].

5.2 The Capital Issues (Control) Act, 1947

Another ingredient of regulatory legislation is the Capital Issues (Control) Act, 1947[28] which prescribes the approval of the Controller of Capital Issues for all issues of capital. It is one of the

[27] The Companies Act, 1956.

major instruments through which the Government regulates the working of capital market particularly the new issues. Capital issues control was first introduced under the Defence of India Rule 94-A which was promulgated on 17 May, 1943 under the Defence of India Act, 1939, Capital Issue Control was retained after the War and Defence Rule 94-A was replaced by the Capital Issues (Continuance of Control) Act, in April, 1947. The main objective of this pragmatic step was to ensure those investments in the country in the various sectors of economy which takes place in a planned manner and in accordance with the priorities laid down in the plans. Despite of it, this legislation had the following objectives:

a) To protect the investing public;
b) To ensure that investments by the corporate sector were in accordance with the plans and that they were not wasteful and in non-essential channels;
c) To ensure that the capital structure of companies was sound and in the pubic interest;
d) To ensure that there was no undue congestion of public issues in any part of the year; and
e) To regulate the volume, terms and conditions for foreign investment.

For the purpose of achieving the above objectives, an office of the Controller of Capital Issues (CCI) was set-up. It was entrusted with the responsibility of regulating the capital issues in the Country. The CCI was vested with the powers to approve the kinds of instruments, size, timing and premium of issues.

The Capital Issues (Control) Act, (CICA) is only of historical interest now as it was repealed by the Capital Issues (Control) Repeal Act 1992. It played an important part in the functioning of the Indian capital market for as many as 45 years since 1947, and its provisions have now become the powers and functions of the SEBI. It was administered by the Controller of Capital Issues (CCI) in the Ministry of Finance, Department of Economic Affairs, Government of India. While the Securities (Control) Repeal Act, (SCRA) mainly regulates the secondary market. The CICA mostly regulates the primary or new issue market for securities.

The Act required companies to obtain prior approval or consent for issues of capital to the public, and for pricing of public and right issues. It empowered the Government of India (GOI) to regulate the timing of new issues by private sector companies, the composition of securities to

---

[28] The Capital Issue (Control) Act, 1947.

be issued, interest (dividend) rates, which can be offered on debentures and preference shares, the timing and frequency of bonus issues, the amount of prior allotment to promoters, floatation costs, and the premium to be charged on securities.

5.3 The Securities Contract (Regulation) Act, 1956

It was proved over time that the provision in Capital Issues (Control) Act were totally inadequate to regulate the growing dimensions of capital market activity. The government realized the necessity of creating a broad based and a more secure environment for the business to grow. This led to the enactment of Companies Act and Securities Contracts (Regulation) Act in 1956. These legislations contained several provisions relating to the issue of prospectus, disclosure of accounting and financial information and listing of securities etc.

The Securities Control (Regulation) Act, 1956 came into force throughout India on 20*^ Feb, 1957. This Act permits only those exchanges which have been recognized by the Central Government to function in any notified state or area. It prescribes the requirements which a company must comply with before its shares can be listed on any recognized stock exchange in the country[29].

There is no statutory obligation that every public limited company should get its shares listed on a recognized stock exchange. However, a company declaring in the prospectus, its intention of applying for enlistment, is bound Under Section 73 of the Companies Act, to make a listing application to the stock exchange concerned. It is also bound to abide by the prescribed requirements in order to have its shares admitted to dealings failing which; it has to refund the application money to those who have subscribed for the share capital. Further, the Government reserves the powers under section 21 of the Securities Contracts (Regulation) Act, 1956 to compel a Public Limited Company when it is so necessary or expedient, in the interest of the trade or of the public to comply with the prescribed requirements and list its shares on a recognized stock exchange.

The objective of the Securities Contracts (Regulation) Act (SCRA) is to regulate the working of stock exchanges or secondary market with a view to prevent undesirable transactions or

[29] L. M. Bhole, "Financial Institution and Markets: Structure**, Growth, and Innovation, Tata McGraw-Hill Publishing Company Limited, New Delhi, 2007, pp. 7-12

speculation in securities, and thereby, to build up a healthy and strong investment market in which the public could invest with confidence. It empowers the GOl to recognize and derecognize the stock exchanges, to stipulate laws and by-laws for their functioning, and to make the listing of securities mandatory on stock exchanges by Public Limited Companies (PULCOs). It prohibits securities transactions outside the recognized stock exchanges. It lays down that all contracts in securities except short delivery contracts, can be entered only between and through the members of recognized stock exchanges. It prescribes conditions or requirements for listing of securities on recognized stock exchanges. It empowers the GOI to supercede the governing bodies of stock exchanges, to suspend business on recognized stock exchanges, to declare certain contracts illegal and void under certain circumstances, to prohibit contracts in certain cases, to license the security dealers, and to lay down penalties for contravention of the provision of the Act. It is administrated by the Ministry of Finance, Department of Economic Affairs, GOI[30].

This Act aims at having a strong and healthy investment market so that members of the public may invest their savings with full confidence.

5.4 The Reserve Bank of India (RBI)

The financial system deals in other people's money and, therefore, their confidence, trust and faith in it is crucially important for its smooth functioning. Financial regulation is necessary to generate, maintain and promote this trust. One reason why the public trust may be lost is that some of the savers or investors or intermediaries may imprudently take too much risk, which could engender defaults, bankruptcies, and insolvencies. A regulation is needed to check prudence in the system.

The modern trading technology and the possibility of high leveraging enable market participants to take large stake which are disproportionate with their own investments. There are frequent instances of dishonest, unfair, fraudulent, and unethical practices or activities of the market intermediaries or agencies such as brokers, merchant bankers, custodians, trustees, etc. The regulation becomes necessary to ensure that the investors are protected; that disclosure and access to information are adequate, timely, and equal; that the participants measure upto the rules

[30] The Securities Contracts (Regulation) Act, 1956.

of the market place; and that the markets are both fair and efficient. To regulate financial system, RBI has special role and responsibility.

The RBI, as the central bank of the Countiy, is the centre of Indian financial and monetary system. As the apex institution, it has been guiding, monitoring, regulating, controlling, and promoting the destiny of the Indian Financial System (IFS) since its inception. It started functioning from April 1, 1935 on the terms of the Reserve Bank of India Act, 1934. It was a private shareholders' institution till January, 1949, after which, it became a State-owned institution under the Reserve Bank (Transfer to Public Ownership) of India Act, 1948. This Act empowers the Central Government, in consultation with the Governor of the Bank, to issue such directions to it as they might consider necessary in the public interest. Further, the Governor and all the Deputy Governors of the Bank are appointed by the Central Government.

The Bank is managed by a Central Board of Directors; four Local Boards are to advise the Central Board on matters referred to them. They are also required to perform duties as are delegated to them. The final control of the Bank vests in the Central Board which comprises the Governor, four Deputy Governors, and fifteen Directors nominated by the Central Government. The committee of the Central Board consists of the Governor, the Deputy Governor and such other Directors as may be present at a given meeting.

Functions of RBI

The RBI functions with in the framework of mixed economic system. With regard to framing various policies, it is necessary to maintain close and continuous collaboration between the government and the RBI. The main functions of the Reserve Bank are as follows;

i) To maintain monetaky satiability so that the business and economic life can deliver welfare gains of a properly functioning mixed economy;

ii) To maintain financial stability and ensure sound financial institutions so that monetary stability can be safely pursued and econom.ic units can conduct their business with confidence;

iii) To maintain stable payments system so that financial transactions can be safely and efficiently executed;

iv) To promote the development of financial infrastructure of markets and systems, and to enable it to operate efficiently i.e., to play a leading role in developing a sound financial system so that it can discharge its regulatory function efficiently;

v) To ensure that credit allocation by the financial system broadly reflects the national economic priorities and social concerns;

vi) To regulate the overall volume of money and credit in the economy with a view to ensure a reasonable degree of price stability.

The Reserve Bank is entrusted with the function of the development and regulation of money, foreign exchange, and government securities markets. The RBI undertakes this function as it is a monetary authority as well as debt manager to the government and is responsible for the stability of the financial system. To preserve and enhance the stability of the banking and financial system, there is an important part of the "promotional" role of the RBI. In fact, financial stability has now assumed relatively greater importance as one of the tasks of the RBI. This is evident in its work to formulate prudential norms for banks and financial institutions, its intervention in the foreign exchange market, and its participation in the operation of "safety nets" i.e., the legal and organizational structure for overseeing the safety and soundness of the banking and financial system. It plays an important role in building-up and maintaining confidence in the underlying stability of the IPS. In short, the RBI helps to create and maintain a stable, efficient, and well functioning financial system in India[31].

5.5 Securities and Exchanges Board of India (SEBI) Act, 199 2

The year 1991 witnessed a big push being given to liberalization and reforms in the Indian financial sector. For sometime thereafter, the volume of business in the primary and secondary securities markets increased significantly. As part of the same reform process, the globalization or internationalization of the Indian financial system made it valunerable to external shocks. The multi-crore securities scam rocked the IFS in 1992. All these developments impressed on the authorities the need to have in place a vigilant regulatory body or an effective and efficient watchdog. It was felt that the then existing regulatory framework was fragmented, ill-coordinated, and inadequate and that there was a need for an autonomous, statutory, integrated

31

organization to ensure the smooth functioning of the IFS. The SEBI came into being as a response to these requirements.

The SEBI was established on April 12, 1988 through an administrative order, but it became a statutory and really powerful organization only since 1992. The CICA was repealed and the office of the CCl was abolished in 1992, and SEBl was set-up on 21 February, 1992 through an ordinance issued on 30 January, 1992. The ordinance was replaced by the SEBI Act on 4 April, 1992. Certain powers under certain sections of SCRA and CA have been delegated to the SEBI. The regulatory powers of the SEBI were increased through the Securities Laws (Amendment) Ordinance of January, 1995 which were subsequently replaced by an Act of Parliament. The SEBI is under the overall control of the Ministry of Finance, and has its head office at Mumbai. It has become now a very important constituent of the financial regulatory framework in India.

The philosophy underlying the creation of the SEBI is that multiple regulatory bodies for securities industry i.e. the regulatory systems get divided, causing confusion among market participants as to who is really in command. In a multiple regulatory structure, there is also an overlap of functions of different regulatory bodies. Through the SEBI, the regulation model which is sought to be put in place in India, is one in which every aspect of securities market regulation is entrusted to a single highly visible and independent organization, which is backed by a statute, and which is accountable to the Parliament and in which investors can have trust.

5.5.1 Constitution and Organization

Chapter II of the SEBI Act deals with establishment, incorporation, administration and management of the Board of Directors etc. The SEBI is a body of six members comprising the Chairman, two members from amongst the officials of the ministers of the Central Government dealing with finance and law, two members who are professionals and have experience or special knowledge relating to security market, and one member from the RBI. All members, except the RBI members, are appointed by the government, who also lay down their terms of office, tenure, and conditions of service, and who can also remove any member from office under certain circumstances. The Central Government is empowered to supersede the SEBI in public interest, on account of grave emergency when it is unable to discharge its functions or duties, or if its financial position and administration deteriorates.

The work of the SEBI has been organized into five operational departments each of which is headed by an executive director who reports to the chairman. Besides, there is a legal department and the investigation department. The departments have been divided into divisions. The various departments and scope of their activities are as follows:

- **The Primary Market Policy, Intermediaries, Self-Regulatory Organization (SROs), and Investor Grievance and Guidance Department**

It looks after all policy matters and regulatory issues in respect of primary market, registration, merchant bankers, portfolio management services, investment advisers, debenture trustees, underwriters, SROs and investor grievance, guidance, education and association.

- **The Issue Management and Intermediaries Department**

It is responsible for vetting of all prospectuses and letters of offer for public and right issues, for co-ordinating with the primary market policy, for registration and regulating and monitoring of issues related intermediaries.

The Secondary Market Policy, Operations and Exchange Administration, New Investment Products and Insider Trading Department

It is responsible for all policy and regulatory issues for secondary market and new investment products, registration and monitoring of members of stock exchanges, administration of some of the stock exchanges, market surveillance and monitoring of price movements and insider trading, and Electronic Data Processing (EDP) and SEBI's data base.

The Secondary Market Exchange Administration, Inspection and Non-member Intermediaries Department

It looks after the smaller stock exchanges of Guwahati, Magadh, Indore, Manglore, Hyderabad, Bhubaneshwar, Kanpur, Ludhiana and Chochin. It is responsible for inspection of all stock exchanges, and registration, regulation and monitoring of non-member intermediaries such as subbrokers.

Institutional Investment (Mutual Funds and Foreign Institutional Investment), Mergers and Acquisition, Research and Publications, and International Relations and IOSCO Department.

It looks after policy, registration, regulation and monitoring of foreign Institutional Investors (FIIs), domestic mutual funds, mergers and substantial acquisition of shares, and IOSCO (International Organization of Securities Commissions) membership, international relations, and research, publication and Annual Report of SEBI.

• Legal Department

This department looks after all legal matters under the supervision of General Counsel.

• Investigation Department

This department carries out inspection and investigation under the supervision of Chief Investigator. The SEBI has regional offices at Calcutta, Chennai and Delhi. It has also formed two non-statutory advisory committees namely-the Primary Market Advisory Committee and Secondary Market Advisory Committee with members from market players, recognized investors associations, and other eminent persons.

SEBI is a member of IOSCO, an international body comprising of security regulators from over 100 countries. It participates in the Development Committee of IOSCO which provides a platform for regulators from emerging markets to share their views and experience[32].

Regulatory Approach

The overall objective of the SEBI, as enshrined in the Preamble of the SEBI Act> 1992 is "to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected there with or incidental thereto". The objectives of SEBI are as follows:

[32] L. M. Bhole, "Financial Institution and Markets: Structure**, Growth, and Innovation, Tata McGraw-Hill Publishing Company Limited, New Delhi, 2007, pp. 7-12.

• To protect the interest of investors so that there is a steady flow of savings into the capital market.

• To regulate the securities market and ensue fair practices by the issuers of securities so that they can raise resources at minimum cost.

• To promote efficient services by brokers, merchant bankers and other intermediaries so that they become competitive and professional[33].

Having regard to the emerging nature of the securities markets in India, the SEBI necessarily has the twin task of regulation and development. Its regulatory measures are always meant to be subservient to the needs of the market development. Underlying those measures is the logic that rapid and healthy market development is the outcome of well regulated structures. In this spirit, the SEBI endeavors to create an effective surveillance mechanism and encourages responsible and accountable autonomy on the part of all players in the market, who are expected and required to discipline themselves and observe the rules of the market. The self-regulation and regulation by exception are thus the coroner stones of its regulatory framework. The SEBI believes that selfregulation can work only if there is an effective regulatory body overseeing the activities of self-regulatory organizations.

The SEBI also aims at facilitating an efficient mobilization and allocation of resources through the securities markets, stimulating competition, and encouraging innovations. Its regulation is expected to be flexible, cost-effective and confidence-inspiring. To investors, the SEBI provides a high degree of protection of their rights and interests through adequate, accurate, and authentic information and disclosure of such information on a continuous basis. To issuers, it provides a market place in which they can confidently raise all the finance they need in an easy, fair, and efficient manner. To the market intermediaries, it offers a competitive, professionalized and expanding market with adequate and efficient infrastructure so that they can render batter and more responsible service to the investors and issuers.

[33] The Securities Contracts (Regulation) Act, 1956.

5.5.2 Powers, Scope , and Functions

The scope of operations of the SEBI is very wide. It can frame or issue rules, regulations, directives, guidelines, norms in respect of both the primary and secondary markets, intermediaries operating in these markets, and certain financial institutions. SEBI has been vested with the following powers:

1) Power to call periodical return from recognized stock exchanges.
2) Power to call any information or explanation from recognized stock exchanges or their members.
3) 3) Power to direct enquiries to be made in relation to affairs of stock exchanges or their members.
4) Power to grant approval to bye-laws of recognized stock exchanges.
5) Power to make or amend bye-laws of recognized stock exchanges.
6) Power to control listing of securities by public companies.
7) Power to control and regulate stock exchanges.
8) Power to grant registration to market intermediaries.
9) Power to levy fees or other charges for carrying-out the purpose of regulation.
10) Power to declare applicability of Section 17 of Securities Contract (Regulation) Act in any state or area to grant licenses to dealers in securities.

5.5.3 SEBI and Central Government

The Central Government has the powers to issue directions to the SEBI Board, to supersede the Board, if necessary and to call for return and report etc. as and when it finds necessary. The Central Government has also powers to give any guidelines or to make regulations and rules for SEBI and its operations.

The activities of the SEBI are financed by grants from the Government in addition to fees, charges etc. collected by SEBI. The fund called the SEBI General Fund, is set-up to which all grants, fees, charges etc. are credited. The fund is used to meet the expenses of the Board and to pay salaries of staff and remuneration to officers and members of the Board etc.

5.6 SEBI Guidelines for Primary Market and Secondary Market

SEBI has brought out a number of guidelines separately, from time to time, for primary market and secondary market. These are:

5.6.1 Guidelines for Primary Market

New Company: A new company is one (a) which has not completed 12 months of commercial production and does not have audited results and (b) where the promoters do not have a track record. These companies have to issue shares only at par.

New Company Set-up by Existing Company: When a new company is being set-up by existing companies with a five year track record of consistent profitability and a contribution of at least 50 percent in the equity of new company, it is free to price its issues, i.e., it can issue its shares at premium.

Private and Closely tleld Companies: The private and closely held companies having a track record of consistent profitability for at least three years, are permitted to price their issues freely. The issue price is determined only by the issue in consultation with lead managers to the issue.

Existing Listed Companies: The exiting listed companies are allowed to raise fresh capital by freely pricing expanded capital provided the promoters' contribution is 50 percent first Rs. 100 crores of issue, 40 percent on next Rs. 200 crores, 30 percent on the next Rs. 300 crores and 15 percent on balance issue amount.

Reservation of Issues

Reservation under public subscription for various categories of persons is made in the following manner:

1. Permanent employees 10%
2. Indian Mutual Funds 20%
3. Foreign Institutional Investors 15%
4. Development Financial Institutions 20%
5. Shareholders of group of companies 10%

Composite Issues

In the case of composite issue, i.e., right cum public issue by existing listed companies, differential pricing is allowed. In other words, issue to the public can be priced differentially as compared to issue to right shareholders. However> justification for the price difference is required to given in the offer document.

Lock -in –period

Lock-in-period is five years for promoters' contribution from the date of allotment or from the commencement of commercial production whichever is late. At present, the lock-in period has been reduced to one year.

Guidelines for Public Issue

1. Abridged prospectus has to be attached with every application.
2. A company has to highlight the risk factors in the prospectus.
3. Objectives of the issue and cost of project is required to be mentioned in the prospectus.
4. Company's managenient, past history and present business of firm is to be highlighted in the prospectus.
5. Particulars in regard to company and their listed companies under the same mafiagement which made any capital issues during the last three years are to be stated in the prospectus.
6. Justification for premiums, in the case of premium is to be stated.
7. Subscription list for public issues is to be kept open for a minimum of three days and a m.aximum of 10 working days.

5.6.2 Guidelines for Secondary Market

Stock Exchange

1. Board of Directors of stock exchange has to be reconstituted so as to include non-members, public representatives, government representatives to the extent of 50 percent of total number of members.

2. Capital adequacy norms have been laid down for members of various stock exchanges depending upon their turnover of trade and other factors.
3. Working hours of all stock exchanges have been fixed uniformly.
4. All the recognized stock exchanges have to inform about the transaction with in 24 hour.
5. Guidelines have been issued for introducing the system of market making in less liquid scrips in a phased manner in all stock exchanges.

Brokers

1. Registration of brokers and sub-brokers is made compulsory.
2. In order to ensure that brokers are professionally qualified and financially solvent, capital adequacy norms for registration of brokers have been evolved.
3. Compulsory audit of broker's book and filing of audit report with SEBI have been tnade mandatory.
4. To bring about greater transparency and accountability in the broker-client relationship, SEBI has made it mandatory for brokers to disclose transaction price and brokerage separately in the contract notes issued to the client.

5.7 SEBI's Recent Regulatory Developments

The board has taken various measures in the interest of investors in securities market and for development of the securities market and various regulations have been notified in this regard. These regulations are as follows:

5.7.1 Amendments to the Existing Regulations

i) The SEBI (Mutual Funds) Regulations, 1996 have been amended on April 16, 2008 to permit mutual funds to launch Real Estate Mutual Funds. Existing Mutual Funds shall become eligible to launch real estate mutual funds if they have adequate number of experienced key personal directors.

ii) The SEBI (Foreign Institutional Investors) Regulations, 1995 have been amended on May 22, 2008. The main features of the captioned amendment regulations were as fallows:

a) The FIIs who are currently issuing Offshore Derivatives Instruments (ODIs) with total value of PNs outstanding (excluding derivatives) as percentage of their AUC in India, of less than 40 percent, shall be allowed to issue further ODIs only at the incremental rate of 5 percent of their Assets Under Custody (AUC) in India. The 5 percent incremental issuance allowed to such FIIS would be applicable on an annual basis, till such time that the percentage reaches 40 percent, after which the entity will abide by the proposal applicable to entities above the 40 percent limit.

5.7.2 Development of New Regulations

i) The Securities Laws (Amendment) Act, 2004 amended the Securities Contracts (Regulation) Act, 1956 [SC(R) A] to enable SEBI to provide for disclosure-based regulation for public issue of listing of securities debt instruments on the recognized stock exchanges with a view to develop market for securitized debt instruments. Accordingly, on May 26, 2008, SEBI notified the regulations, inter-alia , covering cost of transactions, competition policy, the professional expertise of credit rating agencies, disclosures and obligations of the parties involved in the transaction and the interest of investors in such instruments.

ii) In order to facilitate development of a vibrant primary market for corporate bonds in India, SEBI has notified Regulations for Issue and Listing for Debt Securities to provide for simplified regulatory framework for issuance and listing of non-convertible debt securities (excluding bonds issued by Governments) issued by any company, public sector understanding or statutory corporations. The regulations do not apply to issue and listing of, securities, debt instruments and security receipts for which separate regulatory regime is in place. The Regulations provide for rationalized disclosure requirements for public issues and flexibility to issuers to structure their instruments and decide on the mode of offering.

iii) SEBI has notified tJie new Regulations for the Securities Exchange Board of India (Intermediaries) Regulations, 2008, on May 26, 2008. The main features of the Regulations are as under:

The Regulations put in place a comprehensive framework which applies to all intermediaries. The common requirements such as grant of registration, gefteral obligations, common code

of conduct, common procedure for action in case of default and miscellaneous provisions have been provided in the approved Intermediaries Regulations.

b) The registration granted to intermediaries has been made permanent subject to the compliance of the SEBI Act, regulations, updation of relevant disclosures and payment of fees[34].

[34] L. M. Bhole, ... op. cit., pp. 7.1.

CHAPTER-6

LEGISLATIONS AND REGULATORY BODIES FOR PREVENTION OF CORPORATE FRAUDS IN INDIA

The existence of sound and healthy financial system is a pre requisite for the economic development of a nation. Capital market facilities mobilization of saving of individuals and pool them into reservoir of capital which can be used for the economic development of country unless the interest of investors are protected, the smooth flow of capital by corporate is not possible. An efficient and healthy capital market provides for mechanism for raising of capital and also for protecting the interest of investors. In the last two decade, far reaching development has taken place in the working of capital market.

Several legislations were made in Indian capital market to create a healthy and efficient atmosphere and to protect the interest of investors. The primary object of these legislations is to protect the interest of investors and to inspire the confidence in the mind of those who actively involved it by controlling fraduently and unfair trade practices. The legislation also regulated various financial intermediaries like mutual funds, venture capital, underwriters, merchant banker etc.

The capital issues Act, 1947 was the first piece of legislation passed in India to control the capital market. The Act originally came into being in the year 1943, with the objectives of channelizing resources to support the second world war. It was retained with some modifications as a means of controlling the raising of capital by companies and to ensure that national resources were channelized for desirable purposes to serve the goals and priorities of government and to protect the interest of investors. Under the act, any firm intending to issue securities had to obtain approval from the central government, which fixed the amount, type and price of issues. As a part of liberalization process the act was repealed in 1992 which paved the way for market determined allocation of resources. Other regulation governing security Market is following:

- The Companies Act ,2013
- The Security Exchange Board of India, 1992

- The Security Contract (Regulation) Act, 1956
- The Depositories Act, 1996.
- The Insurance Regulation and Development Act, 1999
- Reserve Bank of India Act, 1935.
- Foreign Exchange Management Act, 1999
- The Securitisation and Reconstruction of Financial Assets and
- Enforcement of Security of Interest Act, 2002
- The Securities Law (Amendments) Act, 2014

6.1 The Companies Act 2013

The Companies Act, 1956, which was enacted with the object to consolidate and amend the law relating to companies and certain other associations, had been in force for about 55 years and had undergone several amendments. However a need was felt to enact a new legislation to meet the changed national and international economic environment and to further accelerate the expansion and growth of economy .For this purpose The Companies Bill, 2009 was introduced in the parliament. Subsequent to it central government introduced a lot of suggestions for amendments in the said Bill. The parliament standing committee on finance and suggestions of various stakeholders, the Central Government withdrew the Companies Bill, 2009. Incorporating the recommendation of the Parliament Standing Committee on Finance and suggestions of all stakeholders The Companies Bill, 2012 was introduced in Parliament and received the assent of the President on the 29th August, 2013. The Companies Act, 2013 makes provision for E-Governance. It provides for one Man Company. Section 211 makes provision for serious fraud investigation office. In the earlier Act no such office was created. Section 29 provides that the securities offered to public shall be in dematerlised form by complying with the provisions of the Depositories Act, 1996 and the regulations made there under. And it further lays down that Any company, other than a company mentioned in sub-section (1), may convert its securities into dematerialised form or issue its securities in physical form in accordance with the provisions of this Act or in dematerialised form in accordance with the provisions of the Depositories Act, 1996 and the regulations made there under. The Companies Act ,1956 incorporated this provision in Sect 66 B. This provision is incorporated to ensure transparency and liquidity in market. Earlier peoples avoided to invest their money in capital market as in case of urgent

matters it was not possible to sell it and take money. So they consider it safe to deposit it in bank. For the protection of interest of investors Section 36 makes further provision for punishment for fraudently inducing person to invest money. It provides that any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into.:-

a) any agreement for, or with a view to, acquiring, disposing of, subscribing for, or underwriting securities; or
b) any agreement, the purpose or the pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities; or
c) any agreement for, or with a view to obtaining credit facilities from any bank or financial institution, shall be liable for action under section 447.

Section 40 further lays down that 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 securities to be dealt with in such stock exchange or exchanges. Sect 41 provides for Issuance of depository receipt. It lays down that A company may, after passing a special resolution in its general meeting, issue depository receipts in any foreign country in such manner, and subject to such conditions, as may be prescribed. This provision was also not contained in earlier Act. Section 74 makes provision for repayment of deposits, etc, accepted before the commencement of the act makes provision for punishment in case of default. It provides that where in respect of any deposit accepted by a company before the commencement of this Act, the amount of such deposit or part thereof or any interest due thereon remains unpaid on such commencement or becomes due at any time thereafter, the company shall-

a) file, within a period of three months from such commencement or from the date on which such payments, are due, with the Registrar a statement of all the deposits accepted by the company and sums remaining unpaid on such amount with the interest payable thereon along with the arrangements made for such repayment, notwithstanding anything contained in any other law for the time being in force or under the terms and conditions subject to which the deposit was accepted or any scheme framed under any law; and

repay within one year from such commencement or from the date on which such payments are due, whichever is earlier.

b) (2) The Tribunal may on an application made by the company, after considering the financial condition of the company, the amount of deposit or part thereof and the interest payable thereon and such other matters, allow further time as considered reasonable to the company to repay the deposit.

c) (3) If a company fails to repay the deposit or part thereof or any interest thereon within the time specified in sub-section (1) or such further time as may be allowed by the Tribunal under sub-section (2), the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one crore rupees but which may extend to ten crore rupees and every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both.

Section 75 provides for damages for fraud. If a company fails to repay the deposit or part thereof or any interest thereon referred to in section 74 within the time specified in sub-section (1) of that section or such further time as may be allowed by the Tribunal under sub-section (2) of that section, and it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, without prejudice to the provisions contained in subsection (3) of that section and liability under section 447, be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors. Both these provisions were not have any place in earlier Act. Section 120 requires the maintains and inspection of document in electronic form. Section 121 Every listed public company shall prepare in the prescribed manner a report on each annual general meeting including the confirmation to the effect that the meeting was convened, held and conducted as per the provisions of this Act and the rules made. Section 135 makes mandatory responsibility toward society. Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee. The Committee shall formulate and recommend to the Board, a Corporate Social Responsibility Policy which

shall indicate the activities to be undertaken by the company and also recommend the amount of expenditure to be incurred on the activities and monitor the Corporate Social Responsibility Policy of the company from time to time. The Board of every company after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company. The Board of every company referred to in sub-section (1), shall ensure that the company spends, in every financial year, at least two per cent. of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy: Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility. Section 195 of companies Act prohibits insider trading of securities. It provides that no person including any director or key managerial personnel of a company shall enter into insider trading: Provided that nothing contained in this sub-section shall apply to any communication required in the ordinary course of business or profession or employment or under any law and if any person engages in insider trading he shall be punished. Insider Trading has been defined as;-

(i) an act of subscribing, buying, selling, dealing or agreeing to subscribe, buy, sell or deal in any securities by any director or key managerial personnel or any other officer of a company either as principal or agent if such director or key managerial personnel or any other officer of the company is reasonably expected to have access to any non-public price sensitive information in respect of securities of company; or

(ii) an act of counselling about procuring or communicating directly or indirectly any non-public price-sensitive information to any person;

(iii) price-sensitive information‖ means any information which relates, directly or indirectly, to a company and which if published is likely to materially affect the price of securities of the company.

(iv) Section 211 provides for establishment of the Serious Fraud Investigation Office to investigate frauds relating to a company by central government and section 212 provides procedure for investigation and also bars the investigation by other agency.

Sect 229 provides that if a person who is required to provide an explanation or make a statement during the course of inspection, inquiry or investigation, or an officer or other employee of a company or other body corporate which is also under investigation destroys, mutilates or falsifies, or conceals or tampers or unauthorized removes, or is a party to the destruction, mutilation or falsification or concealment or tampering or unauthorised removal of, documents relating to the property, assets or affairs of the company or the body corporate or makes, or is a party to the making of, a false entry in any document concerning the company or body corporate; or provides an explanation which is false or which he knows to be false, he shall be punishable for fraud under Sect 447. The punishment provided under Section 447 is without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force. If any person is found to be guilty of fraud he shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.[35]

The Companies Act, 2013 has also make mandatory for a company to have independent director. Sect 149 lays down that every company shall have at least one third of total number of directors as independent directors and Central Government may prescribe the minimum number of independent director s in case of any public companies. Clause 6 of Sect 149 defines independent director as-

An independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director,[36]

(a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

[35] —fraud in relation to affairs of a company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss

[36] Section 149 of The Companies Act 2013

(b) who is or was not a promoter of the company or its holding, subsidiary or associate company;

(c) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

(d) who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

(e) none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

(f) who, neither himself nor any of his relatives

(g) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

(h) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of

(A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

(B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;

(iii) holds together with his relatives two per cent. or more of the total voting power of the company; or

(iv) is a Chief Executive or director, by whatever name called, of any nonprofit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or who possesses such other qualifications as may be prescribed.

The companies Act 2013 has incorporated a lot of reform in order to protect the interest of investors and to ensure transparency and accountability in Companies. Now it is mandatory for the companies to have independent director. Independent director are mandatory for protecting the interest of investors. If there would not be independent director then in that case the director (who is not independent) would act for the benefit of himself and not for the company. Other major reform is Sect 211 which provides for establishment of serious fraud investigation. This provision was not incorporated in earlier Act. This provision is incorporated to investigate the corporate fraud and Sect 75 makes the personal liability of a person who fails to repay the deposit or commit fraud which cause damage. The Act also includes the provision of corporate Socio Responsibility i.e. responsibility of corporate world toward society.

6.1.1 Various Authorities Constituted under the Act

6.1.2 National Financial Reporting Authority (NFRA)

Sect 132 empowers the Central Government may constitute NFRA for accounting and auditing standards under this Act. It 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 the Central Government and such other members not exceeding fifteen consisting of parttime and full-time members as may be prescribed.

6.1.3 Functions of National Financial Reporting Authority

It shall (a) make recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies or class of companies or their auditors, as the case may be;

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

(c) oversee the quality of service of the professions associated with ensuring compliance with such standards, and suggest measures required for improvement in quality of service and such other related matters as may be prescribed; and (d) perform such other functions relating to clauses (a), (b) and (c) as may be prescribed.

6.1.4 Power of NFRA

- Power to investigate, either suo motu or on a reference made to it by the Central Government, 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. Provision to it further provide that no other institute or body shall initiate or continue any proceedings in such matters of misconduct where the National Financial Reporting Authority has initiated an investigation under this section;
- 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 the National Financial Reporting Authority;

(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;

- where professional or other misconduct is proved, have the power to make order for imposing penalty of not less than one lakh rupees, but which may extend to five times of the fees received, in case of individuals; and not less than ten lakh rupees, but which may extend to ten times of the fees received, in case of firms;
- Debarring the member or the firm from engaging himself or itself from practice as member of the Institute of Chartered Accountant of India referred to in clause (e) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 for a minimum period of

six months or for such higher period not exceeding ten years as may be decided by the National Financial Reporting Authority.

6.1.5 The Nomination and Remuneration Committee

Sect 178 lays down the Board of Directors of every listed company and such other class or classes of companies, as may be prescribed shall constitute the Nomination and Remuneration Committee consisting of three or more non-executive directors out of which not less than one-half shall be independent directors Provided that the chairperson of the company (whether executive or non-executive) may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such Committee.

6.1.6 Functions of Committee

- The Nomination and Remuneration Committee shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal and shall carry out evaluation of every director‘s performance.
- The Nomination and Remuneration Committee shall formulate the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees.

6.1.7 The Serious Fraud Investigation Office

Sect 211 empowers the Central Government to establish an office to be called the Serious Fraud Investigation Office to investigate frauds relating to a company. The Serious Fraud Investigation Office shall be headed by a Director and consist of such number of experts from the following fields to be appointed by the Central Government from amongst persons of ability, integrity and experience in,

banking;

- corporate affairs;
- taxation;

- forensic audit;
- capital market;
- information technology;
- law; or such other fields as may be prescribed.

Where any case has been assigned by the Central Government to the Serious Fraud Investigation Office for investigation under this Act, no other investigating agency of Central Government or any State Government shall proceed with investigation in such case in respect of any offence under this Act and in case any such investigation has already been initiated, it shall not be proceeded further with and the concerned agency shall transfer the relevant documents and records in respect of such offences under this Act to Serious Fraud Investigation Office. Where the investigation into the affairs of a company has been assigned by the Central Government to Serious Fraud Investigation Office, it shall conduct the investigation in the manner and follow the procedure provided in this Chapter; and submit its report to the Central Government within such period as may be specified in the order.

6.1.8 National Company Law Tribunal

Sect 408 provides for constitution of National Company Law Tribunal consisting of a President and such number of Judicial and Technical members, as the Central Government may deem necessary

Sect 409 prescribes qualification of member. The President shall be a person who is or has been a Judge of a High Court for five years. A person shall not be qualified for appointment as a Judicial Member unless he

- is, or has been, a judge of a High Court; or
- is, or has been, a District Judge for at least five years; or
- has, for at least ten years been an advocate of a court.

A person shall not be qualified for appointment as a Technical Member unless he

1. has, for at least fifteen years been a member of the Indian Corporate Law Service or Indian Legal Service out of which at least three years shall be in the pay scale of Joint Secretary to the Government of India or equivalent or above in that service; or
2. is, or has been, in practice as a chartered accountant for at least fifteen years;
3. is, or has been, in practice as a cost accountant for at least fifteen years; or
4. is, or has been, in practice as a company secretary for at least fifteen years; or
5. is a person of proven ability, integrity and standing having special knowledge and experience, of not less than fifteen years, in law, industrial finance, industrial management or administration, industrial reconstruction, investment, accountancy, Labour matters, or such other disciplines related to management, conduct of affairs, revival, rehabilitation and winding up of companies; or
6. is, or has been, for at least five years, a presiding officer of a Labour Court, Tribunal or National Tribunal constituted under the Industrial Disputes Act, 1947.

6.1.9 National Company Law Appellate Tribunal

Sect 410 lays down that the Central Government shall, constitute an Appellate Tribunal to be known as the National Company Law Appellate Tribunal consisting of a chairperson and such number of Judicial and Technical Members, not exceeding eleven for hearing appeals against the orders of the Tribunal. Sect 411 further provides the qualification of chairperson and member of the tribunal. It lays down that the chairperson shall be a person who is or has been a Judge of the Supreme Court or the Chief Justice of a High Court and a Judicial Member shall be a person who is or has been a Judge of a High Court or is a Judicial Member of the Tribunal for five years. And a Technical Member shall be a person of proven ability, integrity and standing having special knowledge and experience, of not less than twenty-five years, in law, industrial finance, industrial management or administration, industrial reconstruction, investment, accountancy, labour matters, or such other disciplines related to management, conduct of affairs, revival, rehabilitation and winding up of companies.

Sect 423 further lays down that any person aggrieved by any order of the Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of receipt of the order of the Appellate Tribunal to him on any question of law arising out of such order.

6.2 Security Exchange Board of India Act, 1992

It was officially established by The Government of India in the year 1988 and given statutory powers in 1992 with SEBI Act 1992 being passed by the Indian Parliament. The Securities and Exchange Board of India (SEBI) was constituted on 12 April 1988 as a non statutory body through an administrative Resolution of the Government for dealing with all matters relating to development and regulation of the Securities market and investor protection and to advise the government on all these matters.[37] SEBI was given statutory status and powers through and ordinance promulgated on January 30, 1992. SEBI was established as a statutory body on 21 February 1992. The ordinance was replaced by an Act of Parliament as 4th April 1992. The Preamble of SEBI Act, 1992 enshrines the objectives of SEBI - to protect the interest of investor in securities market and to promote the development of and to regulate the securities market. The statutory powers and functions of SEBI were strengthened through the promulgation of the Securities Laws (Amendment) Ordinance on 25th January 1995, which was subsequently replaced by an Act of Parliament. Before SEBI Act, 1992, the three principal Acts governing the securities market were: (a) the Capital Issues (Control) Act, 1947, which restricted issuer's access to the securities market and controlled the pricing of issues; (b) the Companies Act, 1956, which sets out the code of conduct for the corporate sector in relation to issue, allotment and transfer of securities, and disclosures to be made in public issues; and (c) the Securities Contracts (Regulation) Act, 1956, which provides for regulation of transactions in securities through control over stock exchanges.[38] The Capital Issues (Control) Act, 1947 had its origin during the war in 1943 when the objective was to channel resources to support the war effort. The Act was retained with some modifications as a means of controlling the raising of capital by companies and to ensure that national resources were channelled into proper lines for desirable purposes to serve goals and priorities of the government, and to protect the interests of investors. Under the Act, any firm wishing to issue securities had to obtain approval from the Central Government, which also determined the amount, type and price of the issue. Major part of the liberalisation process was the repeal of the Capital Issues (Control) Act, 1947 in May 1992. With this, Government's control over issue of capital, pricing of the issues, fixing of premia and rates of interest on debentures etc. ceased. The office which administered the Act was abolished and the

---

[37] www.wikipedia.com visited on 26th March 2014

[38] http://shodhganga.inflibnet.ac.in visited on 26th March 2014

market was allowed to allocate resources to competing uses. However to ensure effective regulation of the market, SEBI Act, 1992 was enacted to empower SEBI with statutory powers for (a) protecting the interests of investors in securities, (b) promoting the development of the securities market, and (c) regulating the securities market. Its regulatory jurisdiction extends over corporate in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market. SEBI can specify the matters to be disclosed and the standards of disclosure required for the protection of investors in respect of issues; can issue directions to all intermediaries and other persons associated with the securities market in the interest of investors or of orderly development for securities market; and can conduct enquiries, audits and inspection of all concerned and adjudicate offences under the Act. In short, it has been given necessary autonomy and authority to regulate and develop an orderly securities market.

The SEBI is managed by its members, which consists of following: a) The chairman who is nominated by Union Government of India. b) Two members, i.e. Officers from Union Finance Ministry. c) One member from The Reserve Bank of India. d) The remaining 5 members are nominated by Union Government of India; out of them at least 3 shall be whole-time members.

6.2.1 Establishment and Incorporation of Board.[39]

The head office of the board shall be at Bombay; but it may establish office at other place in India; and its other offices are located at Delhi, Kolkatta and Chennai.

6.2.3 Management of SEBI.[40]

All questions which come up before any meeting of SEBI shall be decided by a majority votes of the members present and voting, and, in the event of an equality of votes, the chairman or, in his absence, the person presiding, shall have a second or casting vote.

An interested party, like a company director can be a member of SEBI. But if he has any direct or indirect, pecuniary interest in any matter coming up for consideration at a meeting of SEBI, he

[39] Section 3 of the SEBI Act 1992
[40] Section 4 of SEBI Act 1992

shall disclose the nature of his interest and shall not take part in deliberations or decision of SEBI in respect of that matter.

6.2.6 Functions of SEBI.[41]

The principal function of SEBI are:

- Protecting the interest of investors in securities.
- Promoting and development of securities market.
- Regulating the securities market.

Section 11(1) of the Act casts upon SEBI the duty to protect the interest of investors in securities and to promote development of and to regulate the securities market through appropriate measures.

These measures provided for:

- Regulating the business in stock exchange and any other securities market.
- Registering and regulating the working of stock brokers, sub-brokers, share Transfer agents, bankers to an issue, trustee of trust deed, underwriters, port folio manager and such other intermediaries who may be associated with securities market in any manner.
- Registering and regulating the working of collective investment scheme including mutual funds, venture capital funds.
- Promoting and regulating self-regulating organizations.
- Prohibiting fraudulent and unfair trade practice in securities market.
- Promoting investors education and training to intermediaries in securities market.
- Prohibiting insider trading in securities.
- Regulating substantial acquisition of shares and take over of companies;
- Registration and regulating the work of depositories and depositories participants.
- Registration and regulating the work of foreign institutional investors, credit rating agencies etc.

---

[41] Section 11 of SEBI Act 1992

- Undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds and other persons associated with the securities market.
- Performing such functions and exercising such powers under the provisions of [The Capital Issues Control Act 1947] and SCRA Act 1956 as may be delegate to it by the central government.
- Conducting research for the above purpose.

6.2.7 Powers of SEBI

- SEBI may take any of the following measures in the interest of investors or securities market:
- Suspends the trading of any security in a stock exchange.
- Retrain or prohibit any person from accessing the securities market.
- Suspends any office – bearer of any stock exchange.
- Impound and retain the proceeds or securities in respect of any transaction under investigation.
- Attach bank account(s) of any intermediary or any person associated with the securities market, for a period not exceeding one month.

SEBI is vested with powers to take action against practices relating to securities market manipulation and misleading statements to include sale/purchase of securities.

SEBI has the powers of civil court in respect of discovery and production of books, documents, records, accounts, summoning and enforcing attendance of person/company and examining them under oath. SEBI can levy fines for violations relating to failure to submit information to SEBI/to enter in to agreements with clients/to redress grievances of investors, violation by mutual fund. Issuing commissions for the examination of witnesses or documents.

6.2.8 Securities Appellate Tribunal [SAT]

Establishment of SAT10 :- The central government shall by notification, establish one or more appellate tribunals to be known as SAT to exercise the jurisdiction, powers and authority conferred on such tribunal by or under this Act or any other law for the time being in force.

The central government shall also specify in the notification referred to sub-section (1) the matters and places in relation to which the SAT may exercise jurisdiction.

Composition of SAT[42]

:- SAT shall comprise of the following

- one presiding officer
- two other members

The presiding officer and two other members, to be appointed, by notification by the central government. Provided that SAT used to comprise of only one person i.e. presiding officer before SEBI [Amendment] Act, 2002 came in to effect from 29th October, 2002, shall continue to exercise the jurisdiction, powers and authority conferred on it by or under this Act or any other law for the time being in force till two other members are appointed under this section.

6.2.9 Presiding Officer

The presiding officer of SAT shall be appointed by the central government in consultation with the Chief Justice of India. The person to be appointed as the presiding officer must be a sitting or retired judge of the Supreme Court or a sitting or a retired Chief Justice of a High Court. The presiding officer shall hold his office for a period of five years or up to the age of 68 years, whichever is earlier.

6.2.10 Members

The two members of SAT shall be appointed by the central government. The members shall hold their office for a period of five years or up to the age of 62 years, whichever is earlier.

6.2.11 Disqualification for Member.[43]

A person shall not be qualified for appointment as member of SAT unless he is a person of ability, integrity and Standing who has shown capacity in dealings with problems relating to

---

[42] Section 15 L of SEBI Act 1992
[43] Section 15 (m) of SEBI Act 1992

securities market and has qualification and experience of corporate law, securities laws, finance and economics or accountancy.

6.2.12 Appeal to SAT13

Any person aggrieved:

- by an order of the SEBI, made under
- by an order made by an adjudicating officer under SEBI Act, 1992,

May prefer an appeal to SAT. However, no appeal shall lie to SAT from an order made by SEBI or adjudicating officer, with the consent of parties. The appeal to SAT shall be filed within a period of 45 days from 100. The date of receiving the copy of the order of SEBI or adjudicating officer, as the case may be. However, SAT may entertain an appeal after the expiry of 45 days, if it is satisfied that there was sufficient cause for not filing it within that period. On receipt of an appeal, SAT may confirm, modify or set aside the order appealed against, after giving an opportunity of being heard. It shall send a copy of every order made by it to the following persons:- (1) SEBI (2) Concerned Adjudicating Officer (3) Parties to Appeal

6.2.13 Powers of SAT.[44]

The SAT shall have, for the purpose of discharging their functions under SEBI Act, 1992 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:

Summoning and enforcing the attendance of any person and examining him on oath.

Requiring the discovery and production of documents.

Receiving evidence on affidavits.

Issuing commissions for the examination of witnesses or documents.

- Reviewing its decisions; it can review only when law has given this power.

[44] Section 15 U of SEBI Act, 1992

- Dismissing an application for default or deciding it ex-parte.
- Setting aside any order of dismissal of any application for default or any order passed by it ex-parte.
- Any other matter, which may be prescribed.

Any person aggrieved by any decision or order of SAT may file an appeal to the Supreme Court. It may be noted that the appeal can be made only on any question of law and not on the questions of fact. The appeal shall be filed within 60 days from the date of receiving a copy of decision or order of SAT. However, the Supreme Court may allow a further period of 60 days for making an appeal, if it is satisfied that the applicant was prevented by sufficient cause from filing the appeal within the first 60 days. Thus, SEBI is a statutory body, was formed in January 1992 as a single agency to look after control over capital market and ensure its orderly growth. Investor‘s protection is one of its major objectives.

6.2.15 Analysis of Judgments of SAT

In **Sterlite Industries Vs. Union of India.**[45]

It was held that SEBI has wide discretionary powers to regulate the securities market and protect the interest of investors.

In **BSE Brokers Forum Vs. SEBI**[46]

It was held that SEBI cannot grant registration certificate with retrospective effect. Registration will be valid from date of issue of registration certificate and not from date of application to SEBI for registration.

In LKP Securities Ltd. Vs. SEBI[47]

In this case, it was held that violation of code of conduct by intermediary [broker in this case] itself is violation of regulation and if violation is established, certificate of registration can be suspended.

---

[45] Sterlite Industries Vs. Union of India (2002) 38 SCL 592
[46] BSE Brokers Forum Vs. SEBI (2003) 48 SCL 266 [SAT]
[47] LKP Securities Ltd. Vs. SEBI (2003)41 SCL 1 [sat]

In Dalmia Securities Vs. G.S. Reddy[48]

It was held that SEBI can put some conditions while granting registration or its renewal. However, such conditions should be fair and reasonable, as SEBI is a public authority.

In Chintamani Shares and Broking Ltd. Vs. Securities and Exchange Board of India. Appeal No.203 of 2009

In this case the scrip of a company namely BSEL and MSL are listed on the Bombay Stock Exchange and also on the National Stock Exchange. The primary charge that is leveled against the appellants is that they along with some others formed a group and executed trades within that group which were circular.

In Mukesh Dokania and Co. Vs. Securities and Exchange Board of India[49]

The appellant is a registered stock broker and a member of the Calcutta stock exchange. It is the sole proprietorship concern of Mukesh Dokania. He was been found to have executed manipulative trades in the scrip of Minolta finance Ltd. On behalf of his clients and the adjudicating officer by his order dated July 9, 2009 has imposed on him a monetary penalty of Rs 6 lacs for violating regulations 3 and 4 of the SEBI [Prohibition of Fraudulent and Unfair Trade Practices relating to securities market] Regulations, 2003 and also the code of conduct prescribed for the stock brokers All modern economies, therefore, recognize the need for sound regulation of securities markets. This is needed not just for proper functioning of these markets, but also for their very survival. It will ensure that markets are safe and perceived to be safe by the public at large and necessary information is available to the public so that they can take informed decisions about investments. It will further ensure that while engines of growth are allowed to move at full speed, there is no space for manipulators in the system. Today securities market regulation has evolved to include three principal objectives: (a) Fair, efficient and transparent markets; (b) Investor protection; (c) Reduction of systemic risk. I am happy to say that SEBI shouldering the responsibility in all these three areas with great deal of efficiency and

---

[48] Appeal no 159 of 2009
[49] visited on 27th Sept 2013

commitment. Thus the SEBI has issued various regulations in respect of each of the intermediaries such as stock brokers and sub broker, share transfer agents and registrars to an issue, banker to an issue, debenture trustees, merchants bankers, underwriters portfolio manager, depositories , participants, custodian of securities, foreign institutional investors, credit rating agencies, venture capital funds, collective investment schemes including mutual funds, etc to regulate and ensure fair play by these intermediaries. SEBI has also issued regulations to prohibit insider trading and to regulate substantial acquisition of shares and take over of companies. All these rules and regulations, circulars and guidelines serve the objective of affording necessary protection to the investors. Over and above this, various penalties and adjudications which could be imposed on persons including the various intermediaries who are held to have contravened provisions of the enactment and committed defaults. The Act thus provides sufficient deterrents to those who may indulge in defaults and illegalities and malpractices on the market to the detriment of the investors.

6.3 The Depositories Act, 1996

The Depositories Act ,1996 has introduced the system of depositories in India. It has come in to force with effect from 20th September, 1995.

A depository is organizations where the securities of an investor are held in the electronic form at his request through the medium of a depository participate[50]. If the investor wants to utilize the services offered by a Depository, the investor has to open a beneficiary account with the Depository through a DP. DP is the representative or agent in the system and it maintains the investor‘s securities account balances and intimates to holdings from time23. The investor can open account with one or more DPs when a person buys any security e.g. shares and debentures already in the depository mode, the buyer will become owner of the said security in the depository within a day of settlement being made / completed. The buyer is not required to apply to the company for registering the security in his name.

Dematerialization is the process by which physical share certificates are converted in to electronic entries. Rematerialization is the process by which electronic holdings are converted

---

50

back into certificates. The investor has to pay charges to the depository and the DP for opening of account and also for every transaction in the account.

Thus, a depository is an organization like a central bank where the securities of a shareholder are held in the electronic form at the request of the shareholder through the medium of a depository participant, [DP] To utilize the services offered by a depository, the investor has to open an account with the depository through a DP.

Depository means a company formed and registered under the companies Act, 1956 and which has been granted a certificate of registration under section 12(IA) of the SEBI Act 1992[51]

A depository cannot act as a depository unless it obtains a certificate of commencement of business from SEBI. There are two depositories players in the market i.e. national securities depository limited [NSDL] and central depository service [India] Limited [CDSL], all the securities held by a depository shall be dematerialized and shall be in a fungible form. Depository and DP both are regulated by SEBI.

6.3.1 Advantages of Depository System[52]

The depository system gives a less risky settlement with implementation of collateral bases payment systems and greater profits from increased trading volume which are made possible by NCDS systems with reduced operational costs per transaction and reduced risk. There is an improved cash flow from not having funds tied up for long periods. Further forgery and counterfeit have been eliminated with attendant reduction in settlement risk from bad deliveries. The system has led to an opportunity for development of retail brokerage business and for development of more sophisticated custodial services which can be offered to the smaller investor. There are now standardised communications between NCDS, registrars and other intermediaries. Also, there is an ability to arrange pledges without movement of physical scrip and further increase overall level of trading activity, liquidity and profits.

Although India had a vibrant capital market which is more than a century old, the paper-based settlement of trades caused substantial problems like bad delivery and delayed transfer of title till

[51] Section 2(e) of Depository Act. 1996
[52] visited on 31st March 2014

recently. The enactment of Depositories Act in August 1996 paved the way for establishment of NSDL, the first depository in India. This depository promoted by institutions of national stature responsible for economic development of the country has since established a national infrastructure of international standard that handles most of the trading and settlement in dematerialised form in Indian capital market. The procedure relating to depositories is mainly governed by the regulations and bye laws that are framed by the SEBI and the depositories under the power provided by the Depositories Act.

There are immense advantage to the public by reduction of risks associated with loss, mutilation, theft and forgery of physical scrip.[53] Further there is an elimination of financial loss owing to loss of physical scrip and greater liquidity from speedier settlements and reduction in delays in registration. There will be greater opportunities for investment offered by new instrument and services that can be provided only when NCDS is implemented and faster receipt of benefits and rights resulting from corporate actions. There is also an improved protection of shareholder‘s rights resulting from more time communications from the issuer and reduced transaction costs through greater efficiency The system provides Up-to-date knowledge of shareholder‘s names and addresses. And there will be savings in costs of new issues from reduction in printing and distribution costs. It may also lead to increased efficiency of registrar and transfer agent functions and better facilities for communication with shareholders, conveying benefits of corporate actions and information notices. Furthermore there will be an improved ability to attract international investors without having to incur the expenditure of issuance in overseas markets. Immobilisation of securities is done by storing or lodging the physical security certificates with an organisation that acts as a custodian a securities depository. All subsequent transactions in such immobilised securities take place through book entries. The actual owners have the right to withdraw the physical securities from the custodial agent whenever required by them. In short we can say depository system has following advantages:-

- It eliminates bad deliveries.
- It eliminates all kinds if risks associated with physical certificates.
- It provides immediate transfer and registration of securities.
- It provides faster disbursement of non-cash corporate benefits like rights, bonus etc.

---

[53] visited on 31st March 2014

- It provides reduction in handling of huge volumes of paper and periodic status report.
- It eliminates the problems which related with change of address of investor, transmission etc.
- It further eliminates the problems related to selling of securities on behalf of a minor.

6.3.2 Depository Participant

Depository participant [DP] is the agent of the depository and is the interface between the depository and the investor. Just as a broker act an agent of the investor at the stock exchange; a DP is the representative [agent] of the investor in the depository system providing the link between the company and investor through the depository. The DP maintains securities account balances and intimate the status of holding to the account holder from time to time, according to SEBI guidelines; financial institutions like banks, custodians, stocks brokers etc. can become participants in the depositor.

The main characteristics of a depository participant are as under:

- Acts as an agent of depository
- Customer interface of depository
- Functions like securities Bank
- Account opening
- Facilitates dematerialization
- Instant transfer on pay – out
- Credits to investor in IPO, rights, bonus
- Settles trades in electronic segment

Stocking Holding Corporation of India Limited [SHCIL] is the first depository participant in India registered with NSDL. Besides SHCIL, a number of new and private and foreign banks like times Bank, HDFC Bank, ICICI Bank, IDBI Bank, Hong Kong Bank, Standard chartered Bank are providing shares depository services to its customers from its various branches. There are some private depository participants like Alankit and Aphibra also.

6.3.3 Dematerialization

It is a process by which the physical share certificates of an investor is taken back by the company and an equivalent number of securities are created his account in electronic form at the request of the investor. An investor will have to first open an account with a D.P and then, request for the dematerialisation of his share certificates through DP so that the dematerialised holdings can be credited into that account. This is very similar to opening is very similar to opening a bank account.

Thus, it may conclude that the dematerialisation of shares is optional and an investor can still hold shares in physical form. However, he / she has demat the shares if he / she wishes to sell the same through stocks exchanges. Similarly, if an investor purchases shares from the stock exchanges, he / she will get delivery of the shares in demat form.

6.3.4 Fungibility

The act envisages that all securities held in depository shall be fungible i.e. all certificates of the same security shall become interchangeable in the same sense that investor loses the right to obtain the exact certificate he surrenders at the time of entry in to depository.[54]

6.3.5 Legal Framework

The legal framework for a depository system has been laid down by the depositories Act 1996 and is regulated by SEBI. The depository business in India is regulated by

- The depositories Act 1996
- The SEBI [Depositories and Participants] Regulations, 1996

A part from the above, depositories are also governed by the certain provisions of the companies Act, 1956, the India stamp Act, 1899, SEBI Ac, 1992; SCRA 1956, Income tax Act, 1961, benami Transaction [Prohibition] Act, 1988. Banker‘s books evidence Act, 1891.

6.3.6 Right and Obligation of Depository, Depository Participants, Issuers and Beneficial Owner

[54] Section 9 of the depositories Act 1996.

1. Depository shall enter in to an agreement with one or more DP as its agents.
2. Any person, through a DP, may enter in to an agreement with any depository for availing its services.
3. The depository shall be deemed to be the registered owner for the purpose of effecting transfer of ownership of a security on behalf of beneficial owner.
4. A beneficial owner may with the previous approval of depository, create a pledge/hypothecation in respect of security owned by him through its depository.

Any loss caused to beneficial owner due to the negligence of depository or DP the depository shall indemnify such loss to the beneficial owner. There are two depositories functioning in India, namely NSDL and CDSL are as follows:

6.3.7 National Securities Depository Limited [NSDL]

NSDL, the first and largest depository in India, established in August 1996 and promoted by institutions of national stature responsible for economic development of the country has since established a national infrastructure of international standards that handles most of the securities held and settled in dematerialized form in the Indian Capital Market .NSDL crosses one crore demat accounts.

6.3.8 Basic Services

Under the provisions of the Depositories Act, NSDL provides various services to investors and other participants in the capital market like, clearing members, stock exchanges, banks and issuers of securities. These include basic facilities like account maintenance, dematerialization, rematerialization, settlement of traders through market transfers, off market transfers and interdepository transfers, distribution of non-cash corporate actions and nomination transmission.

6.3.9 Central Depository Service (India) Limited [CDSL]

CDSL was promoted by Bombay Stock Exchange Limited [BSEL]; jointly with leading banks such as State Bank of India, Bank of India, Bank of Baroda, HDFC Bank, Standard Chartered Bank, Union Bank of India and Centurion Bank.

CDSL was set up with the objective of providing convenient, dependable and secure depository services at affordable cost to all market participants. Some of the important milestones of CDSL system are:-

CDSL received the certificate of Commencement of business from SEBI in February, 1999.

All leading stock exchanges like the National Stock Exchange, Calcutta Stock Exchange, Delhi Stock Exchange, The Stock Exchange, Ahmedabad, etc. have established connectivity with CDSL.

CDSL's demat service are extended through its agent called DP. The DP is the link between the investor and CDSL. An investor who opens a demat account with DP can utilize the services offered by CDSL.

Depository facilities holding of securities in the electronic form and enables securities transactions to be processed by book entry by a DP, who as an agent of the Depository, offers Depository services to investors. The investor who is known as beneficial owner [BO] has to open a demat account through any DP for dematerialization of his holdings and transferring securities.

The balances in the investors account recorded and maintained with CDSL can be obtained through the DP. The DP is required to provide the investor, at regular intervals, a statement of account, which gives the details of the securities holdings and transactions. The depository system has effectively eliminated paper-based certificates, which were prone to be fake, forged, counterfeit resulting in bad deliveries. CDSL offers an efficient and instantaneous transfer of securities.

The Depository Act which provides for the establishment of depositories like NSDL and CDSL to curb the irregularities in the capital market and protect the interests of the investors and paved a way for an orderly conduct of the financial markets through the free transferability of securities with speed, accuracy and transparency.

6.4 The Securities Contract (Regulation) Act, 1956

The security laws in India are governed by the broad Parameters of Contracts (Regulation) Act 1956. The main purpose of securities law is both facilitatory as well as regulatory. The Securities Contracts (Regulation) Act 1956 was enacted with a view to regulate the market; mainly the secondary market i.e. the stock exchanges. Stock exchanges require greater degree of control since most of the transaction with regard to securities may tend to be speculative in the nature unless tightly regulated. There are various modes by which securities in the market are transacted. If the market, therefore, is not controlled, it would lead to only large scale gambling. The act endows the central government with sweeping power in respect of supervision and control of securities market. It extends to whole of India.

6.4.7 Establishment of Special Courts under Securities Contract (Regulation) Act, 1956.[55]

Sect 26A lays down that the Central Government for the purpose of providing speedy trial of offences under this Act establish or designate as many Special Courts as may be necessary. And it further lays down that a Special Court shall consist of a single judge who shall be appointed by the Central Government with the concurrence of the Chief Justice of the High Court within whose jurisdiction the judge to be appointed is working. A person shall not be qualified for appointment as a judge of a Special Court unless he is, immediately before such appointment, holding the office of a Sessions Judge or an Additional Sessions Judge, as the case may be.

6.6.8 Types of Non Banking Financial Company.[56]

Asset Finance Company (AFC) : An AFC is a company which is a financial institution carrying on as its principal business the financing of physical assets supporting productive/economic activity, such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments, moving on own power and general purpose industrial machines. Principal business for this purpose is defined as aggregate of financing real/physical assets supporting economic activity and income arising there from is not less than 60% of its total assets and total income respectively.

[55] Inserted by The Securities Laws (Amendment) Second Ordinance, 2013 w.e.f. 18-07-
[56] Ibid.

Investment Company (IC) : IC means any company which is a financial institution carrying on as its principal business the acquisition of securities,

Loan Company (LC) : LC means any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.

Infrastructure Finance Company (IFC) : IFC is a non-banking finance company a) which deploys at least 75 per cent of its total assets in infrastructure loans, b) has a minimum Net Owned Funds of Rs. 300 crore, c) has a minimum credit rating of ‗A ‗or equivalent d) and a CRAR of 15%.

Systemically Important Core Investment Company (CIC-ND-SI) : CICND-SI is an NBFC carrying on the business of acquisition of shares and securities which satisfies the following conditions:-

- it holds not less than 90% of its Total Assets in the form of investment in equity shares, preference shares, debt or loans in group companies;
- its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies constitutes not less than 60% of its Total Assets;
- it does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;
- it does not carry on any other financial activity referred to in Section 45I(c) and 45I(f) of the RBI act, 1934 except investment in bank deposits, money market instruments, government securities, loans to and investments in debt issuances of group companies or guarantees issued on behalf of group companies.
- Its asset size is Rs 100 crore or above and It accepts public funds

Infrastructure Debt Fund: Non- Banking Financial Company (IDF-NBFC): IDF-NBFC is a company registered as NBFC to facilitate the flow of long term debt into infrastructure projects. IDF-NBFC raise resources through issue of Rupee or Dollar denominated bonds of minimum 5 year maturity. Only Infrastructure Finance Companies (IFC) can sponsor IDF-NBFCs.

Non-Banking Financial Company - Micro Finance Institution (NBFCMFI): NBFC-MFI is a non-deposit taking NBFC having not less than 85% of its assets in the nature of qualifying assets which satisfy the following criteria:

Non-Banking Financial Company – Factors (NBFC-Factors):

NBFCFactor is a non-deposit taking NBFC engaged in the principal business of factoring. The financial assets in the factoring business should constitute at least 75 percent of its total assets and its income derived from factoring business should not be less than 75 percent of its gross income.

A company incorporated under the Companies Act, 1956 and desirous of commencing business of non-banking financial institution as defined under Section 45 (I) (a) of the RBI Act, 1934 requires registration compulsory. The NBFCs accepting public deposits should furnish to RBI Audited balance sheet of each financial year and an audited profit and loss account in respect of that year as passed in the annual general meeting together with a copy of the report of the Board of Directors and a copy of the report and the notes on accounts furnished by its Auditors;

6.9.1 Sick Industrial Companies (Special Provisions) Act, 1985

To examine and recommend remedy for high industrial sickness in the eighties, the Tiwari committee was set up by the Government. It was to suggest a comprehensive legislation to deal with the problem of industrial sickness. The committee suggested the need for special legislation for speedy revival of sick units or winding up of unviable ones and setting up of quasijudicial body namely; Board for Industrial and Financial Reconstruction (BIFR) and The Appellate Authority for Industrial and Financial Reconstruction (AAIRFR) and their benches. Thus in 1985, the SICA came into existence and BIFR started functioning from 1987.

The objective of SICA was to proactively determine or identify the sick/potentially sick companies and enforcement of preventive, remedial or other measures with respect to these companies. Measures adopted included legal, financial restructuring as well as management overhaul. However, An Assessment process was cumbersome and unmanageable to some extent. The system was not favourable for the banking sector as it provided a sort of shield to the defaulting companies.

6.9.4 SARFAESI ACT, 2002

By the late 1990s, rising level of Bank NPAs raised concerns and Committees like the Narasimham Committee II and Andhyarujina Committee which were constituted for examining banking sector reforms considered the need for changes in the legal system to address the issue of NPAs.[57] These committees suggested a new legislation for securitisation, and empowering banks and FIs to take possession of the securities and sell them without the intervention of the court and without allowing borrowers to take shelter under provisions of SICA/BIFR. Acting on these suggestions, the SARFAESI Act, was passed in 2002 to legalise securitisation and reconstruction of financial assets and enforcement of security interest. The act envisaged the formation of asset reconstruction companies (ARCs)/ Securitisation Companies (SCs).

6.9.5 Provisions of the SARFAESI Act

The Act has made provisions for registration and regulation of securitisation companies or reconstruction companies by the RBI, facilitate securitisation of financial assets of banks, empower SCs/ARCs to raise funds by issuing security receipts to qualified institutional buyers (QIBs), empowering banks and FIs to take possession of securities given for financial assistance and sell or lease the same to take over management in the event of default.

may raise funds from the QIBs[58] by forming schemes for acquiring financial assets. The SC/ARC shall keep and maintain separate and distinct accounts in respect of each such scheme for every financial asset acquired, out of investments made by a QIB and ensure that realisations of such financial asset is held and applied towards redemption of investments and payment of returns assured on such investments under the relevant scheme.

---

[57] "non-performing asset" means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset,-- (a) in case such bank or financial institution is administered or regulated by any authority or body established, constituted or appointed by any law for the time being in force, in accordance with the directions or guidelines relating to assets classifications issued by such authority or body; (b) in any other case, in accordance with the directions or guidelines relating to assets classifications issued by the Reserve Bank;

[58] "qualified institutional buyer" means a financial institution, insurance company, bank, state financial corporation, state industrial development corporation, trustee or securitisation company or reconstruction company which has been granted a certificate of registration under sub-section (4) of Section 3 or any asset management company making investment on behalf of mutual fund or pension fund or a foreign institutional investor registered under the Securities and Exchange Board of India Act, 1992 (15 of 1992) or regulations made thereunder, or any other body corporate as may be specified by the Board

6.9.7 RBI is Regulator for Determine time Limit to NPA

The Gujarat high court on 25th April 2014 has held an amendment in securitization laws as unconstitutional and restored the Reserve Bank of India (RBI) as the regulator of banks and non-banking financial institutes across the country as far as their non-performing assets (NPA) period is concerned73 . Various defaulters questioned an amendment made in November 2004 in the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002. Before this amendment in Section 2(1)(o) of the Act, the RBI was the regulator for banking, non-banking firms and securitization agencies for deciding the period after which the loans could be treated as NPAs. Earlier, the NPA period for all such finance institutions - banks, NBFCs and other agencies - was 180 days. Later in 2004, the RBI kept the NPA period for banks at 90 days and 180 days for NBFCs. However, with the amendment in the law, the finance institutions were free to have their own regulators, and the RBI ceased to be the regulator for the purpose. With this, the NPA period was decided separately by all finance firms, which differed in each of the cases. Aggrieved with the discrepancy, some defaulters of banks and NBFCs moved the HC questioning the reason for the difference of NPA periods among finance firms. Their counsel Vishwas and Masoom Shah contended that this difference was in violation of the right to equality as guaranteed by the Constitution. The HC upheld this argument, declared the amendment as unconstitutional with observation that the Parliament was wrong in snatching the power from the RBI to set NPA guidelines.

6.10 The Securities Laws (Amendment) Act, 2014

This Act provides market Regulator SEBI with new power. Earlier the judicial powers were not given to SEBI. But after the passing of this act SEBI has also judicial power. The Act provides for establishment of Special fast Trial Court. The Act has 57 Sections. This act gave the power to search and obtain information, including Call records about any suspected entity from within or outside the firm. The act has amended the SEBI Act 1992, Security Contract (Regulation), Act 1956 and Depository Act. Now The SEBI, which is the regulator of capital market or securities in India Can ask for any information from any authority which it consider necessary for any matter of investigation or inquiry by the board in respect of any transaction in securities. Now even the SEBI can require furnishing of information to other authorities even outside India, having similar functions to the Board in the matter relating to the prevention or detection of

violation of securities laws and for that purpose the Board may enter into agreement with such authority outside India with the prior approval of central government. The punishment has been increased. The law has been made stricter. Sect 28A has been Added which provides for attachment of property movable or immovable, arrest and detention and appointment of receiver in case of failure to comply with any of direction Of SEBI. In Section 19 of The Depository Act, 1996 a explanation has been added which provides that power to issue directions include the power to direct any person, who made profit or loss by indulging in any transaction or activity in contravention of provision of this Act. The other thing which has been amended is related to punishment. Now the punishment provided under the act would be deterrent. These amendments has been introduced after the Shardha chit fund fraud as these fraud has affected the whole of nation and especially the investors' confidence. The Government has realized that there are so many loopholes in the existing law and there is need to overcome these loopholes. So the government has passed this bill on 6 th august by Lok Sabha and on 12th August in Rajya Sabha. Now the act is in force.

In short we can say that this act has empowered the SEBI. And strict punishment has been provided in order to prevent frauds in market. However time will tell whether it would be able to achieve it object or not i.e. would be able to maintain investor's interest in capital market or not.

So a lot of legislation has been enacted for the prevention and control of frauds in corporate world and regulatory authority has been established for ensuring the compliance with the legislation and take action whenever required. When in 1992 SEBI was established after Harshad Mehta Fraud it was thought there would hardly be any fraud capital market. But it was only 3 year of its establishment that Ketan Parekh fraud was committed. At that time question on the efficiency of SEBI was raised and power of the SEBI was increased. The Security Contract (Regulation) Act , 1956 also prevents undesirable transaction in security market. The Highest Authority under the act is Central Government. However some of the power which was earlier conferred on Central Government was transferred to SEBI with amendment so that SEBI can discharge its function efficiently. Then Depository Act, 1996 was enacted with a view to ensure Transparency and accountability and to provide liquidity in market and to introduce paperless security which would reduce the burden of their keeping. Other Act which were also there was IRDA , RBI, FEMA and SERFAESI Act. Recently some amendment has been made in

Companies Act, 1956 like concept of Independent Director was introduced, Serious Fraud Investigation Office was created, it also makes provision for E- Governance and also makes provision for punishment fraudently inducing person to invest money. Various Authorities has been constituted to ensure effective implementation of these legislation Like SAT74, SFIO75, NCLT76, NCLAT77, NFRA78 etc. These are some of authority. However these authorities have failed to discharge its duty as fraud is rampant. Some scholars are of view that now the problem of corporate fraud has been solved and now there would not be any case after the amendment of Companies act, 2013. But this fact also cannot be denied that Implementation of Act is one thing and its Enactment is another thing. Indian Penal Code was enacted in 1860 and many offences were created. Murder is one of such offence in IPC. Punishment which was provided was death sentence which is deterrent punishment. However everyone knows that our newspapers are full of incident of Murder. So the contention of Scholar that the topic has become outdated is not sustainable. So Today we need not more law but their effective implementation as the cases discussed in chapter 4 itself lays down that fraud could have been prevented if the Authorities would not have negligent. So Authorities should alert.

CHAPTER

CONCLUSIONS AND SUGGESTIONS

In recent times, efforts to liberalise the economics and integrate them with the global markets have forced the corporate world to review the role of corporate governance. The Indian economy has consciously shifted from a controlled one to a market driven one. Corporate world needs to assimilate itself to several developments taking place all over, in order to survive and flourish amidst global competition. They can aspire to reach their goals with success if they pursue the right means to that end. The objectives before a business are to create wealth for the society, maintain and preserve that wealth efficiently and to share the wealth with the stakeholders. Corporate governance is the method by which the aforesaid objectives are achieved. Corporate governance mechanisms have been an important issue of enquiry for the researchers in financial economics. A related issue in this literature is the independence and competence of the Board of Directors. The Indian corporate scenario was more or less stagnant till the early 90s but, after the liberalization of the 90s, the position and goals of the Indian corporate sector changed a lot. As engine is the power house which runs the vehicle. Similarly good governance is the powerhouse for the economic growth of company. For the proper functioning of the economy good corporate governance should be practiced which results in reducing wastage of scarce resources. The concept of corporate governance is not just adding up two words, corporate and governance, it is one concept but with multitude of different interpretations. Corporate governance is a voluntary ethical code of business of companies.

In a global economy, customers, investors and expert employees do not accept poor management. Corporate Governance has emerged as a process to ensure that the company is managed in the best interest of all the stakeholders. Corporate governance has been successful in attracting a good deal of public interest because of its obvious importance for the financial help of the corporations. When investors invest money in a corporation, he reposes confidence and good faith in the ability of the corporation's management. It is expected that Board of directors and management must safeguard the economic interests of company and shareholders. The directors are responsible and accountable to various stakeholders, especially the shareholders. The corporate governance is a system of making directors responsible towards entire group of stakeholders for increasing efficiency and managing ethical values. Transparency makes corporate governance more effective and it is the right of shareholder under corporate governance to get to know about internal management. Shareholders

have right to know about financial situation performance and ownership of a company. It improves public understanding of the organisation and consequently the organisation is able to attract investors and enhance the trust and confidence of stakeholders. India's ancient wisdom, which assumes relevance even today, inspires people to work for the larger objective of the well-being of all stakeholders. These sound and all-encompassing values are even more relevant in current times, as organizations grapple with the challenges of modern day enterprises, the aspirations of stakeholders and of citizens eager to be active participants in economic growth and development.

Corporate governance is not just another fashionable word but it is a more important concept and means to an end that of achieving excellence. It is an essential weapon targeting excellence in corporate world. To achieve corporate excellence companies must adhere to established core values. Good corporate governance practices are the underlining factor to achieve corporate excellence. The system of corporate governance is established on the pillars of fairness, accountability, disclosures and transparency. These are the parameters which promote corporate integrity. Corporations are the prominent players in the global markets. They are mainly responsible for generating majority of economic activities in the world, ranging from goods and services to capital and resources. Many efforts are being made, both at the Centre and the State level, to promote adoption of good corporate governance practices, which are the integral element for doing and managing business. However, the concepts and principles of good governance are still not clearly known to the Indian business set up. A time has come to redefine the relationship between the shareholders, management and Board of Directors in the context of managing a corporation. Corporate governance is not just compliance but goes further as is sometimes described as beyond compliance towards building a good governance culture, instilling an environment of trust and confidence. Greater transparency needs to be forced upon corporate in terms of their overall management. The concept of corporate governance is gaining popularity as an instrument of reforms in corporate world in different parts of the world. It has emerged as a major incentive for corporate growth and in increasing business opportunities. Many big and medium companies are making it mandatory for adopting the good practices of corporate governance in their work culture. Transparency, interaction and sharing of information are gaining importance in many corporate houses for setting effective governance standards. Therefore, as the economy grows and corporate emerge as strong contenders in emerging business, there is a need for strong governance norms and proper implementation of the same.

Hence, there is a greater need to increase awareness among entrepreneurs about the various aspects of corporate governance. There are some of the areas that need special attention, namely:-

- Quality of audit, which is at the root of effective corporate governance;
- Role of Board of Directors as well as accountability of the CEOs and CFOs;
- Protection of interests of minority shareholders;
- Vigilance mechanism and prevention of Insider Trading;
- Quality and effectiveness of the legal, administrative and regulatory framework; etc

It is necessary to provide the corporates desired level of comfort in compliance with the code, principles and requirements of corporate governance; as well as provide relevant information to all stakeholders regarding the performance, policies and procedures of the company in a transparent manner. There should be proper financial and non-financial disclosures by the companies, such as, about remuneration package, financial reporting, auditing, internal controls, etc.

In the history of Indian corporate governance, Satyam Scam uprooted the confidence of investors. The scandal emerged in saga of improving corporate governance practices. The scandal has given a sign of cautious among foreign investors. Corporate governance standards need to keep a pace with rapid rise in economic power and the imbalance bring critical results. The Satyam Computers, which is now being remembered mostly for the lightning speed of systemic response to save the company rather than the enormity of the corporate misconduct, also had an elaborate Code of Conduct and Ethics on its website. It was based on "four core values which Satyam stood for" - belief in people, entrepreneurship, customer orientation, pursuit of excellence.

Suggestions

1. Training Institute for Board of Directors: As many Directors are members of the families who have promoted the company and their close relatives, they will be on board without possessing professional skill and qualification. To train them professionally there is a need for an institute and training must be made compulsory. To achieve this statutory provision relating to academic and professional qualification must be included in the Companies Act 1956.

2. Enhancement of Power and Responsibility of Independent Directors: Many committees have recommended for the establishment of independent or nonexecutive directors. But regarding

their powers and responsibility no clear-cut recommendations were made. Hence suitable amendment shall be made to include specific provisions concerning them in the Companies Act 1956.

3. Remuneration of Executive Directors: At present Company Act 1956 in section 198, and 199 fixed it at 5% ofthe net profit and 10% ofthe net profit as the maximum. But these two sections never linked their maximum remuneration to their performance. To ensure proper Corporate Governance it should be linked to their performance.

4. Adaptation oftwo-tier Board System: In the present Companies Act 1956 only single tier board is recognized. But it has not fulfilled the aspiration of the investors and led to many corporate scandals. To control this and ensure proper Corporate Governance two-tier board structure must be introduced. It may be based on the German or Japan model.

5. Conversion of Fiduciary Duties of Directors: At present there is no statutory provision relating to the position of directors^ which in turn determines their duties. There are many provisions in the Companies Act 1956 dealing with liability, civil as well criminal. But there is a need for definition oftheir position and conversion of fiduciary duties into statutory duties. Hence a suitable amendment must be made to the Companies Act 1956 in this regard.

6. Doing Away of Nominee Directors: Institutional investors will enjoy the privilege of appointing nominee directors. This will not serve any purpose, as they are already well protected and they are getting undue advantage against other investors. Hence the provision providing far the nominee directors must be deleted.

7. Investors Insurance Scheme: To protect the interest of, especially small investors, and individual investors, there is a need to introduce 'investors' insurance scheme modeled on 'small depositors' insurance scheme' in the Banking Regulation Act 1949. Initially, premium of this insurance policy is to be paid from company's fund and if the oompany suffers loss due to bad

Corporate Governance of Board of Directors, whatever premium was paid shall be recovered from the directors personally.

BIBLIOGRAPHY