Clarifications relating to independent directors

12 June 2014

The Companies Act, 2013 (the Act) was largely operationalised with effect from 1 April 2014. However, there are a number of implementation issues on which various stakeholders have sought clarifications from the Ministry of Corporate Affairs (MCA). The MCA vide general circular no. 14/2014 dated 9 June 2014 has provided clarifications on the matters relating to pecuniary relationships, appointment and tenure of independent directors (IDs). These issues and clarifications have been discussed below:

Pecuniary relationships

• Section 149(6)(c) requires that an ID should have no pecuniary relationship with a company, its holding, subsidiary or associate company, or their promoters, or directors, during the current and two preceding financial years.

Clarification had been sought as to whether a transaction entered into by an ID with a company, which was at par with the general public and at the same price as was payable/paid by a member of public, would fall within the prohibition on ‘pecuniary relationships’ under the Act.

The MCA has clarified that section 188 exempts those transactions that are in the ‘ordinary course of business and are at an arm’s length price’ from the purview of the related party transactions. Therefore, an ID would not be considered to have a pecuniary relationship under section 149(6)(c) for transactions with a company, its holding, subsidiary or associate company, or their promoters, or directors, provided such transactions are in the ordinary course of business and are at an arm’s length.

• Section 197(5) provides that a director may receive remuneration by way of fee (as may be prescribed in the relevant rules) for participating in Board and other meetings.

Clarification has been sought on whether receipt of remuneration by an ID of a company would be considered as having pecuniary relationship, while considering his appointment in the holding, subsidiary or associate company of such company.

After consulting the Securities and Exchange Board of India, the MCA has clarified that a pecuniary relationship provided in the section 149(6)(c) does not include receipt of remuneration, from one or more companies, by way of fee as provided under section 197(5), reimbursement of expenses for participation in the Board and other meetings and profit related commission as approved by the members in accordance with the Act.
Appointment and tenure of IDs

• Clarification has been sought for IDs appointed prior to 1 April 2014, on whether they can continue and complete their remaining tenure under the Companies Act, 1956 or would they be required to demit office and be re-appointed (should the company so decide) in accordance with the Act.

The MCA considered the relevant provisions of the section 149(5), 149(10) and 149(11). Explanation to section 149(11) provides that any tenure of an ID on the date of the commencement of the Act shall not be counted for his appointment to/holding the office of director under the Act. As a transitional period of one year is provided under section 149(5), the MCA has clarified that appointment of existing IDs under the Act shall be made expressly under section 149(10)/(11) read with Schedule IV of the Act within one year from 1 April 2014, subject to compliance with eligibility and other prescribed conditions.

• Section 149(10) provides for a term of upto five consecutive years for an ID. Clarification has been sought as to whether it would be possible to appoint an ID for a period less than five years.

The MCA has clarified that while appointment of an ID for a term of less than five years would be permissible, appointment for any term (whether for five years or less) is to be treated as one term under section 149(10). Further, such person shall have to demit office after two consecutive terms even if the total number of years of his appointment in such two consecutive terms is less than 10 years. In such a case, the person completing consecutive terms of less than 10 years shall be eligible for appointment only after the expiry of the cooling-off period of three years.

• Paragraph IV(4) of Schedule IV of the Act requires appointment of IDs to be formalised through a letter of appointment. Clarification was sought on whether this requirement would also apply to the appointment of existing IDs.

The MCA has clarified that the appointment of IDs under the Act would need to be formalised through a letter of appointment.

Our comments

• The MCA has provided some much needed clarifications on certain aspects concerning IDs. Industry chambers and professional institutes, in particular, will be pleased to note that their representations have been attended to.

• The MCA clarification with regard to pecuniary relationships is expected to positively impact the availability of IDs.

• It is interesting to note the difference on the prospective applicability of the tenure limit for the appointment of the IDs under the Act, vis-à-vis a retrospective tenure limit for the appointment of the IDs considered under the revised Clause 49 of the Equity Listing Agreement continues despite these clarifications.

The bottom line

These clarifications are a welcome step and help reduce some practical challenges associated with interpreting what is a pecuniary relationship under the Act. There continue to be other areas where clarifications are required under the Act and we can expect that more guidance of a similar nature will emanate from the MCA in the weeks to come.
KPMG in India is pleased to present Voices on Reporting – a monthly series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

In our call this month, we provided practical insights on steps that companies are taking in implementing the requirements under the Companies Act, 2013 that are now effective. We also discussed the key changes that were made in the gazetted version of the rules.

Additionally, we discussed the recent opinion issued by the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI) on accounting for ‘principal only currency swaps’ as well as cover a clarification issued by the ICAI with respect to creation of deferred tax liability on ‘special reserves’ created by banks. Further, we briefly touched upon the proposed new roadmap for adoption of Ind-AS.

Feedback/Queries can be sent to: aaupdate@kpmg.com

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