Amendment Rules w.r.t Whole-time Company Secretary & Secretarial Audit

1. Brief Overview

The Ministry of Corporate Affairs ("MCA") has made certain rules to amend the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 prescribed under the Companies' Act , 2013 ("the Act") in order to regulate the overall management of body corporates and their adherence of corporate law and governance.

These rules called the Companies (Appointment and Remuneration of Managerial Personnel) Amendment Rules, 2020 were notified by the MCA and they shall be applicable in respect of financial years commencing on or after **1st April 2020**.

This alert attempts to elucidate the amendments introduced by illustrating various scenarios and help corporates better understand the compliance requirements.

2. Appointment of Whole–Time Company Secretary

The paid-up share capital ("PSC") threshold relating to mandatory appointment of a whole-time company secretary has been enhanced and henceforth companies with PSC of Rs 10 crore or more would only be required to do so.

As per Section 203(1) of the Act read with amended rule 8 & 8A of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014,

- Every listed company (Section 203)
- Every other public company having a PSC of ten crore rupees or more shall have whole-time key managerial personnel. (Rule 8)
- Every private company which has a PSC of **ten crore rupees or more** shall have a whole -time company secretary. (Rule 8A)

Earlier, Rule 8A stated that every **company** which has a PSC of **five crore rupees or more** shall have a whole -time company secretary (CS). The earlier provision required both unlisted public companies and private companies having PSC of five crores or more to appoint whole time CS. The amended provision covers only private companies having PSC of ten crores or more since unlisted public companies with PSC of 10 crores or more are separately covered under Rule 8 with a requirement to appoint all 3 categories of KMP, i.e MD or CEO, CFO and CS. This is further elucidated in the table below.

One can also note that, the wordings used in the above provision is "**Paid up share capital**" which includes both Equity share capital & Preference Share capital while calculating the threshold limit for appointment of Whole-Time Company Secretary. However, the rules are silent w.r.t cut-off date against which the threshold of PSC has to be assessed – whether as at end of previous financial year or whether at any point of time during the financial year etc.

For instance, if the PSC of private company increases during a particular financial year because of further issue in the form of rights issue/preferential issue/bonus issue etc. , then the rules are silent whether the Company will be required to appoint Company secretary immediately or whether a grace period of 6 months from the occurrence of the relevant event will be provided (by drawing parlance to the grace period of 6 months provided in Section 203 for fresh appointment upon resignation of any KMP) or whether the appointment will be required to be done only in the financial year subsequent to the year in which such relevant event (further issue) occurs etc.. Further if the PSC reduces because of any corporate actions such as buy back, capital reduction etc., the Rules are again silent as to

whether the rules will continue to be permanently applicable despite the reduction of the capital below the specified threshold or shall become inapplicable immediately and the Whole time Company secretary appointed earlier may be removed or whether there will be any cooling off period before the rules become inapplicable.

KMP includes

(i) Managing Director, or Chief Executive Officer or manager and in their absence, a whole-time director;
(ii) Company Secretary; and
(iii) Chief Financial Officer

The below table summarizes the provisions under Section 203(1) of the Act read with rule 8 & 8A of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014.

S.No.	Type	Paid up Share Capital	Earlier Provisions	Amended Provisions
1	Listed Company (Both Public & Private)	Less than 5 Crores	MD or CEO, CFO & CS	MD or CEO, CFO & CS
		Between 5 Crores to 10 Crores		
		Greater than 10 Crores		
2	Unlisted Public Company	Less than 5 Crores	-	-
		Between 5 Crores to 10 Crores	**CS**	**-**
		Greater than 10 Crores	MD or CEO, CFO & CS	MD or CEO, CFO & CS
3	Unlisted Private Company	Less than 5 Crores	-	-
		Between 5 Crores to 10 Crores	**CS**	**-**
		Greater than 10 Crores	CS	CS

Section 203 provides for a penalty of Rs. 5 lakhs on the Company and Rs. 50,000 on every director and KMP who is in default for non-compliance. Further an additional penalty of Rs. 1000 per day has also been provided in case of a continuing default.

3. Secretarial Audit for Bigger Companies

As per Section 204(1) of the Act read with amended Rule 9(1) of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014,

- Every Listed Company;
- Every public company having a PSC of fifty crore rupees or more;
- Every public company having a turnover of two hundred fifty crore rupees or more;
- **Every company having outstanding loans or borrowings from banks or public financial institutions of one hundred crore rupees or more.**

shall annex with its Board's report made in terms of sub-section (3) of section 134, a secretarial audit report, given by a company secretary in practice, in such form as may be prescribed (i.e Form No. MR-3)

Explanation: For the purposes of rule 9(1), it is hereby clarified that the paid-up share capital, turnover, or outstanding loans or borrowings as the case may be, existing on the last date of latest audited financial statement shall be taken into account.

Earlier, only listed companies and public companies above the specific threshold limits of share capital and turnover were required to conduct a mandatory secretarial audit and private companies were outside the purview of secretarial audit. The amended provision includes private companies and also public companies below the specific threshold limits of share capital and turnover but having outstanding loans or borrowings from banks or public financial institutions of one hundred crore rupees or more.

The amendment to Rule 9(1) requiring to conduct Secretarial Audit captures only those companies where loans or borrowings taken from **Banks or public financial institutions (PFI)** amount to Rs. 100 crore rupees or more. **(i.e., Loans from Directors, Body Corporates, Related parties, Deposits received under Chapter V of the Act etc. are not covered).**

As per Section 2(72) of the Act, PFI include LIC, IDFC, institution notified under Section 4A of Companies Act, 1956, such other institution as may be notified by the Central Government in this regard.

The intention of government in bringing the said amendment under Rule 9(1) is to safeguard the interest of the public at large by ensuring that corporates receiving public money in the form of loans from banks & public financial institutions have an adequate compliance and governance structure in place which shall be reconfirmed by an independent secretarial audit.

However, non-inclusion of **deposits accepted from public** by unlisted public companies under Chapter V of the Act in calculating the threshold limit of Rs. 100 crores for applicability of secretarial audit, seems to be an omission on account of oversight since the principle of safeguarding public interest in such entities should equally apply. This may be contrasted with Section 138 of the Act, where deposits amounting to Rs. 25 crores or more has been included as a threshold limit for the mandatory appointment of internal auditor. Various other provisions in the Act such as those related to appointment of independent directors, establishment of vigil mechanism etc. reckons acceptance of public deposits as one of the criteria for the applicability of the related provisions.

Also, to avoid ambiguity, explanation to Rule 9(1) clarifies that PSC, turnover, or outstanding loans or borrowings as the case may be, existing **on the last date of latest audited financial statement** shall be taken into account.

In effect, if the limit of borrowings from Banks or Public Financial Institutions as at 31 March 2020 exceeds Rs. 100 crores, then the Company will have to get secretarial audit done for FY 2020-21 (**the applicable date for the revised rules being for financial years commencing from 1st April 2020**). As a corollary, it may be interpreted that if the borrowings as at 31 March 2021 reduce to less than Rs. 100 crores, then the Company will not have to get the secretarial audit done for FY 2021-22 though the same would have been performed for FY 2020-21.

Section 204 provides for a penalty ranging from Rs. 1 lakh to Rs. 5 lakhs on the Company, every officer who is in default or company secretary in practice for non-compliance.

Illustration 1

Range Ltd, an unlisted public company, has a paid-up Equity share capital of Rs. 7 Crores and Preference Share Capital of Rs. 4 Crores. It has Outstanding Loans as at Balance Sheet date from the following persons.

- Mr. A (Director) : Rs. 10 Crores
- ABC Bank : Rs. 40 Crores
- LIC : Rs. 20 crores
- XYZ Finance Pvt Ltd (NBFC): Rs. 40 Crores.

What are the requirements of Range ltd to be complied under Section 203(1) & Section 204(1) of Companies Act, 2013?

As per section 203(1), Range ltd **should appoint a MD or CEO, a CFO and a CS** as its Paid-up Share Capital is Rs.11 Crores (Preference + Equity) exceeding the limit of Rs. 10 Crores. Range ltd **will not be required to conduct a secretarial audit** as it does not exceed the limits stated under section 204(1) read with Rule 9.

Though sum total of loans is Rs. 110 Crores, calculation of outstanding loans or borrowings as per section 204(1) is Rs. 60 Crores only (Bank and LIC). Loan from Mr. A (Director) & XYZ Finance Pvt Ltd (NBFC) will not be considered in calculation of outstanding loans or borrowings.

Illustration 2

The Audited Financial Statements of XYZ Private Limited states the following.

- Authorised Share Capital – 50 Crores (Out of which 45 Crores is fully paid up)
- Debentures (Listed) – 5 Crores
- Loans & Borrowings – 10 Crores

What are the requirements of XYZ Private Limited to be complied under Section 203(1) & Section 204(1) of Companies Act, 2013?

Since the debentures of the company are listed, XYZ Private Limited is a **listed (private) company** and hence as per Section 203(1), it will be required to appoint a MD or CEO, CFO & CS. Since it is listed company, it should also mandatorily conduct a secretarial audit as per section 204(1) of the Companies Act, 2013 since there is no minimum threshold which is prescribed for Listed companies. This may also be contrasted with the provisions of Section 177 of the Act which explicitly provides for constitution of Audit Committee only by listed public companies whereas the provisions related to appointment of whole time CS and secretarial audit provides for applicability to listed companies in general (which includes companies whose debt securities are listed even if equity is not listed).

4. M2K Remarks

The both amendments seem to be bit varied as one relaxes the requirement of whole-time Company Secretary in unlisted public/private companies having paid up capital less than 10 Crores and the other one is increasing the purview of Secretarial Audit. Secretarial audit will lead to better compliance with the Companies Act and would lead to early detection of non-compliances which would enable authorities to take corrective action. It would eventually lead to strengthening of the corporate governance culture in the country.

It is further recommended that the Government explicitly clarifies the open/ambiguous issues such as those in the nature as specified above, which might have crept in due to inadvertent omissions/lack of clarity.

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