



5 days Virtual Refresher Course

ERNAKULAM BRANCH OF SIRC OF ICAI

*Companies Act, 2013*



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## Section 185,186,188 of the Companies Act 2013

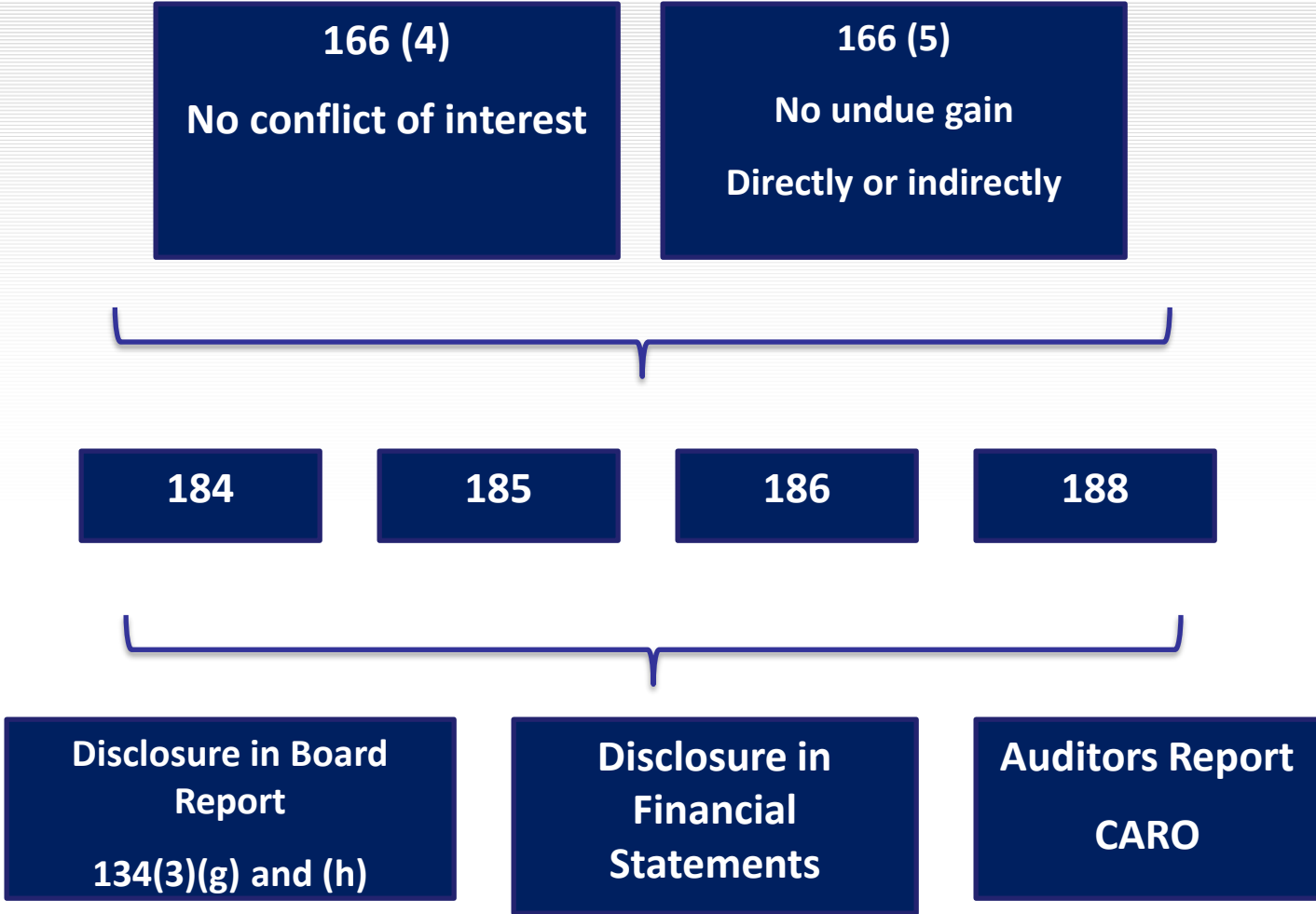
# Items of discussion Today

- ✓ **An in-depth analysis of the intricacies of Sections 185,186,184 and188 – As modified , As enacted and As revised**
- ✓ **Penal provisions**
- ✓ **Sections 185,186,188,184 – Auditor's Duties**



**Discussion Item 1**  
**Sections 185 , 186. 184 and 188**  
**Intricacies and Procedures**

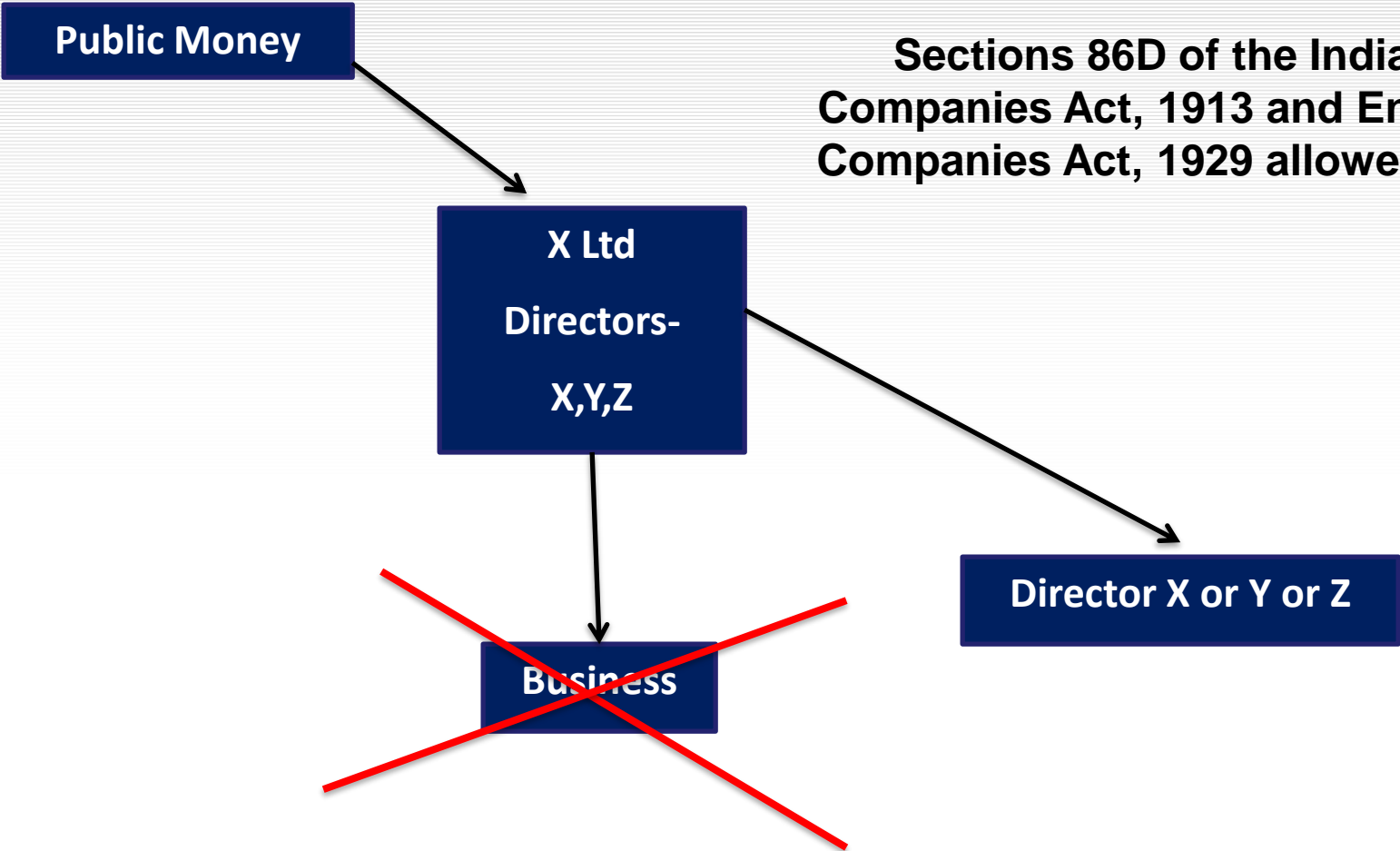
# Section 166(4) and (5) of the Companies Act 2013





## Section 185 – Loans to Directors

# Loans to Directors – Section 185



Sections 86D of the Indian Companies Act, 1913 and English Companies Act, 1929 allowed this

Public Money

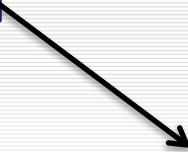
X Ltd  
Directors-  
X,Y,Z

Director X or Y or Z

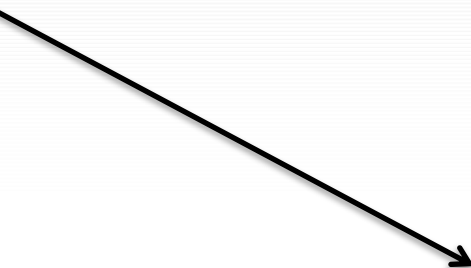
~~Business~~

# Loans to Directors – Section 185

Public Money

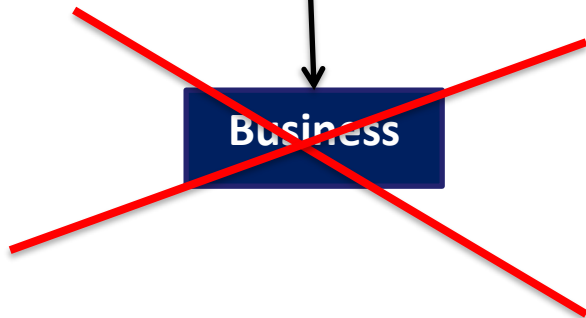


X Ltd  
Directors-  
X,Y,Z



Director X or Y or Z

~~Business~~



Section 295 of Co Act 1956 –  
allowed with CG permission

1960 Amendment Act – Indirect  
Loans into the ambit

# Loans to Directors – Section 185

Public Money

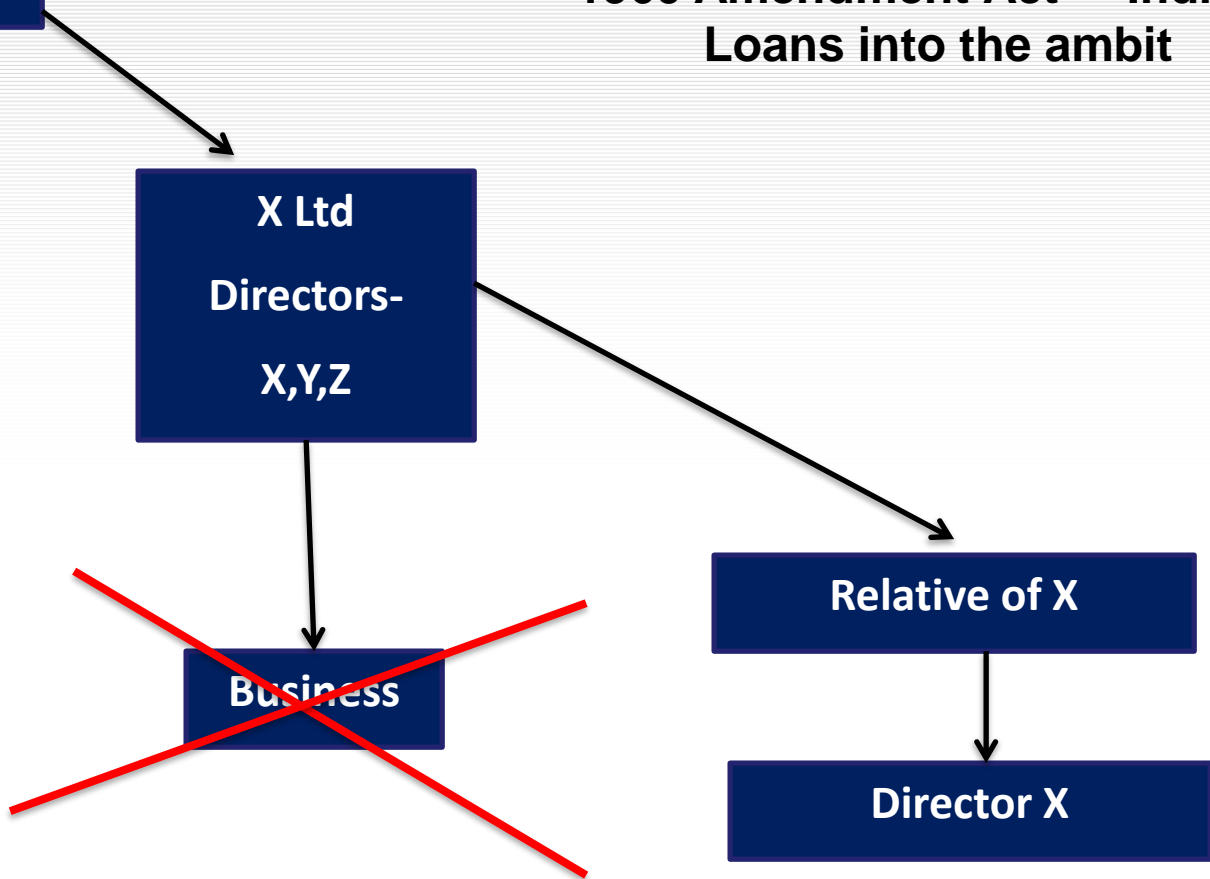
1960 Amendment Act – Indirect Loans into the ambit

X Ltd  
Directors-  
X,Y,Z

~~Business~~

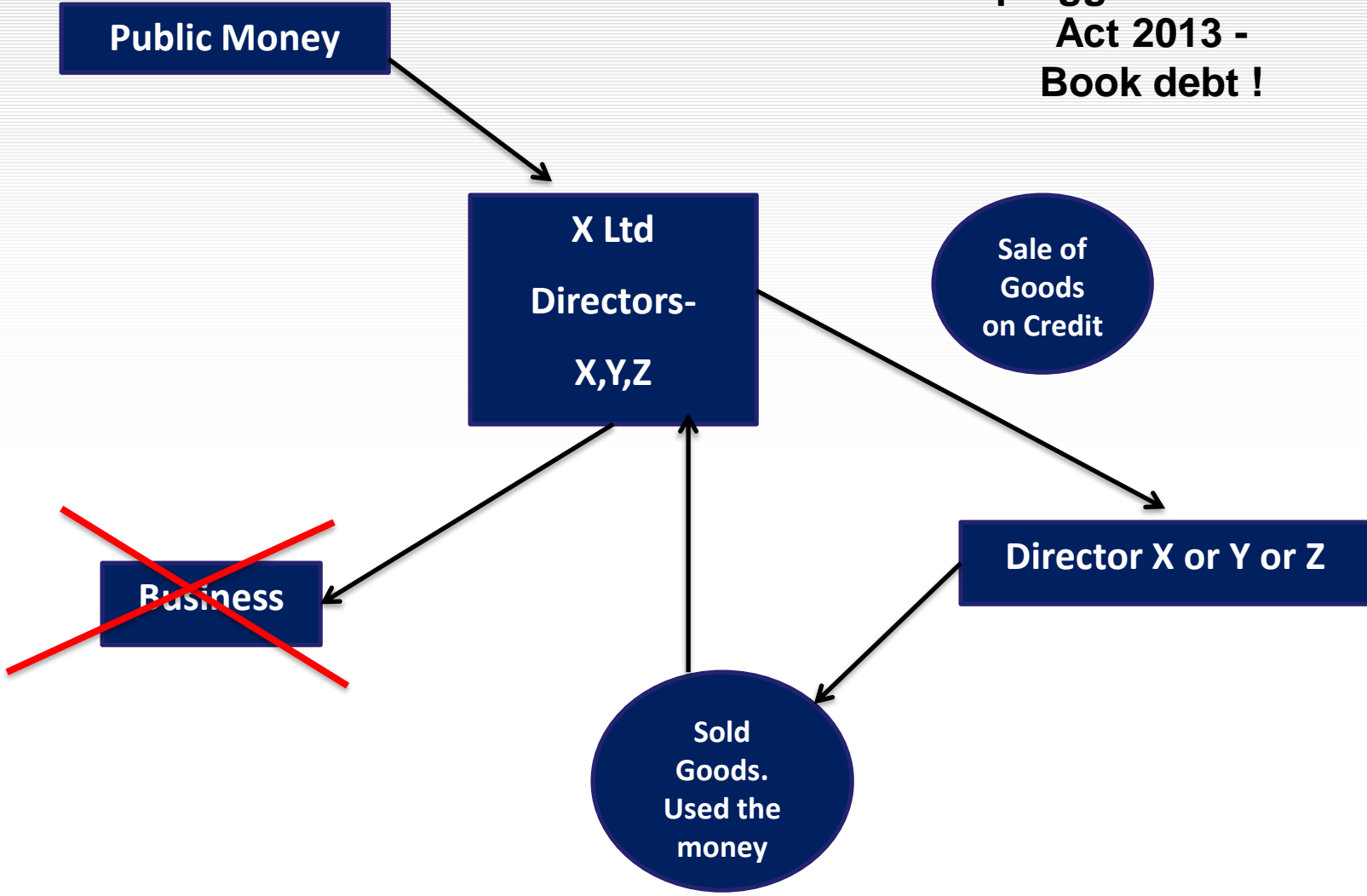
Relative of X

Director X



# Loans to Directors – Section 185

Lacuna is plugged in the Companies Act 2013 - Book debt !



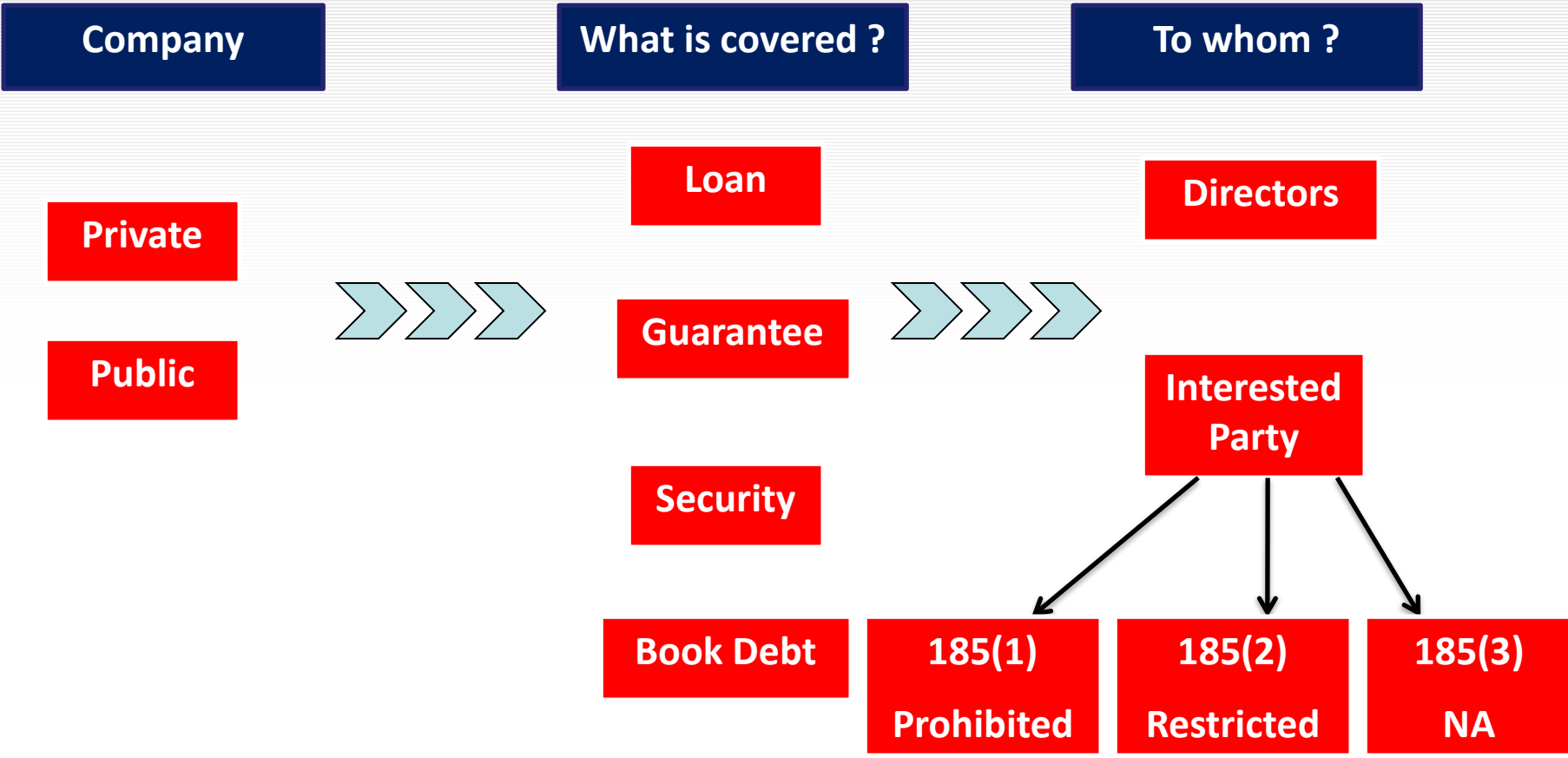
## Loans to Directors – Section 185 – w.e.f 7<sup>th</sup> May 2018

- 1) *No company shall, directly or indirectly , advance any loan , including any loan represented by a book debt to, or give any guarantee or provide any security in connection with any loan taken by **interested party***
  
- 2) *A company may advance any loan including any loan represented by a book debt, or give any guarantee or provide any security in connection with any loan taken by any person in whom any of the director of the company is interested, **subject to conditions***

## Loans to Directors – Section 185

- (3) Nothing contained in sub-sections (1) and (2) shall apply to—
- (a) the giving **of any loan** to a managing or whole-time director—
    - (i) as a part of the **conditions of service** extended by the company to all its employees; or
    - (ii) pursuant to any **scheme approved by the members** by a special resolution; or
  - (b) a company which **in the ordinary course of its business** provides loans or gives guarantees or securities for the due repayment of any loan and in respect of such loans an interest is charged at a rate not less than the rate of prevailing yield of one year, three years, five years or ten years Government security closest to the tenor of the loan; or
  - (c) any loan made by a holding company to its wholly owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company; or
  - (d) any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company:

# Section 185 break-up



**185**  
**Prohibition of Loans to Directors**

**186**  
**LGS – “Person”**  
**BMR + SR**

**179(3)(f)**  
**BMR + Delegation possible to MD**



**Harmonious Construction not possible ?**



## Loan and investment by company Sec 186

- ✓ *Whether specified transactions with parties covered under Section 185 will also be governed by Section 186?*

Section 186 applies to all specified transactions generally. However, Section 185 of the Act prohibits loans to specific related parties. Since 185 deals with parties where conflict of interest is involved, it will prevail over Section 186. If the clause “Save as otherwise provided in the Act” used in Section 185 is construed in a manner to negate the restriction imposed therein, **the very object with which the provision has been enacted will be frustrated**. We have, therefore, to construe the expression “save as otherwise provided by or under the Act” in a harmonious manner so that provision of Section 185(1) is not reduced to a nullity. [**Based on State of Rajasthan v. Noor Mohammad AIR 1973 SC 2729**].

## Loans to Directors – Section 185

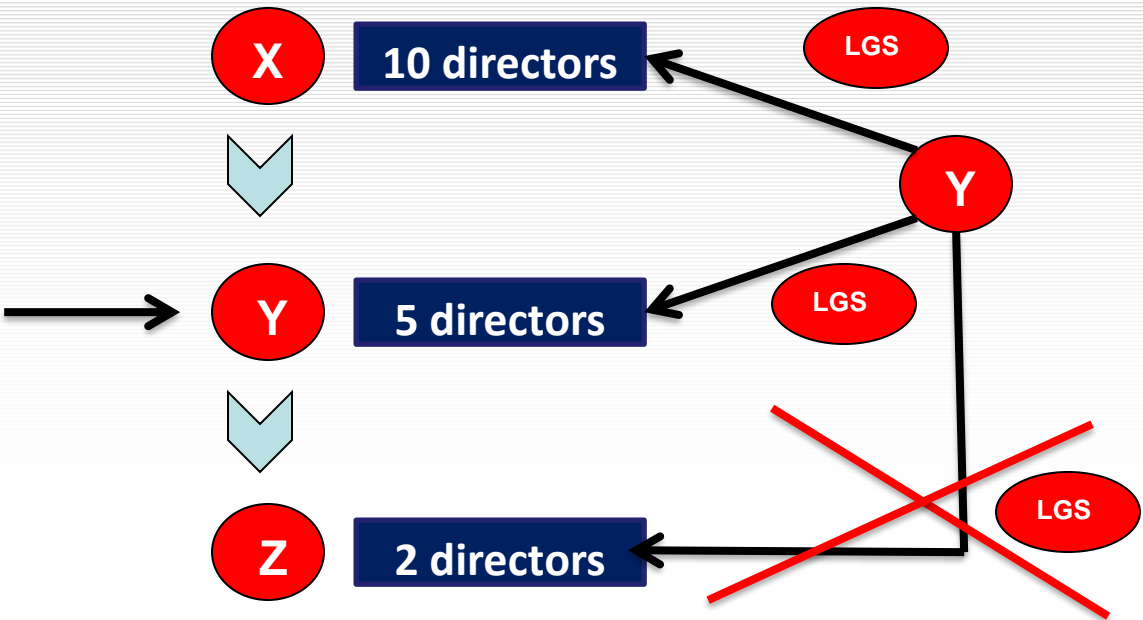
The expression “to any other person in whom director is interested” means

- ✓ 1. to a director of lending company or its holding company.
- ✓ 2. to a relative of any such director.
- ✓ 3. to a partner of such director.
- ✓ 4. to any firm in which such director or a relative is a partner

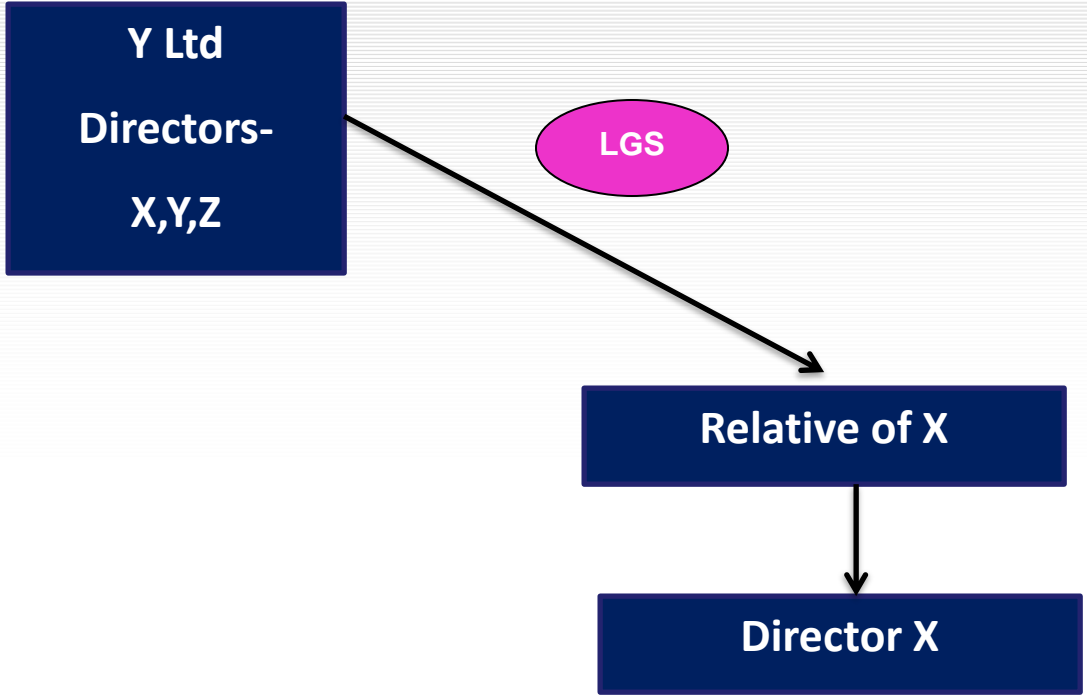
### 185(2) covers

- ✓ 5. to a private company in which such director is a director or a member.
- ✓ 6. to any body corporate in which 25% or more of total voting power is exercised or controlled by one or more such directors.
- ✓ 7. to any body corporate, in which the Board / M.D./Manager is accustomed to act in accordance with directions or instructions of the Board or any director of the lending company

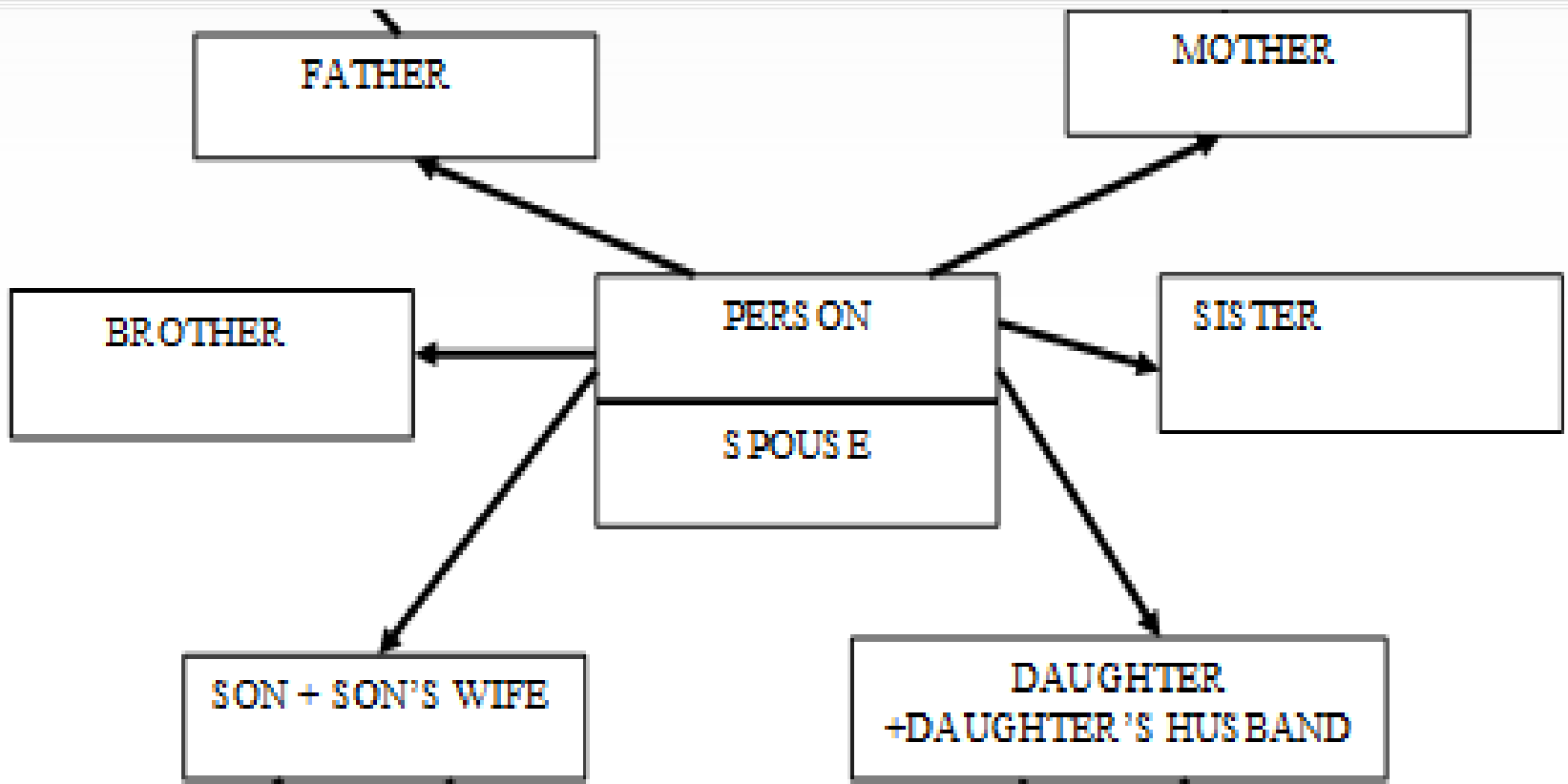
# Director of lending company or its holding company



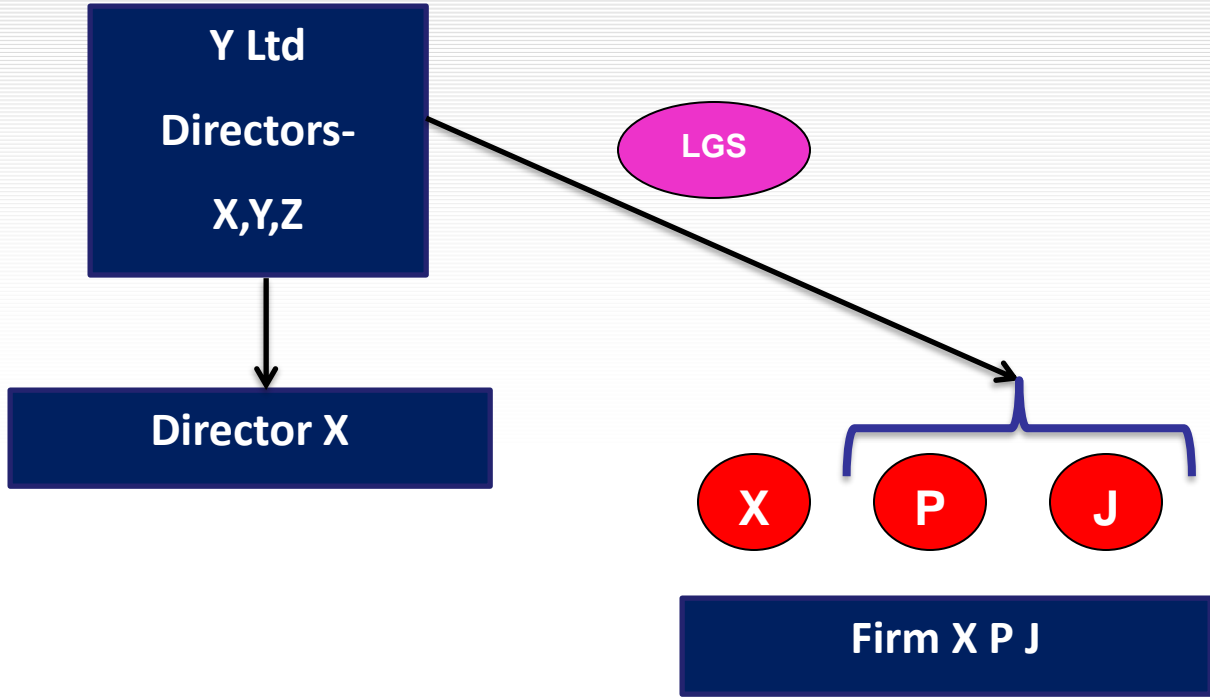
# Relative of such director



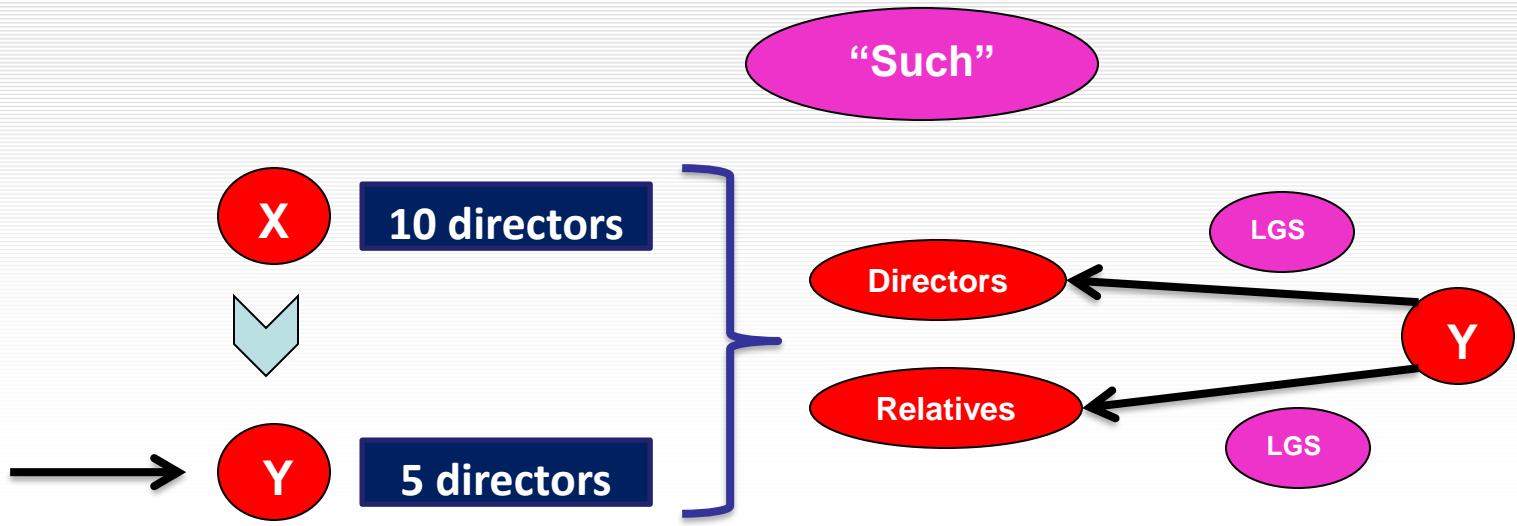
# Relative of such director – Sec 2(77) r/w Rules



# Partner of such director



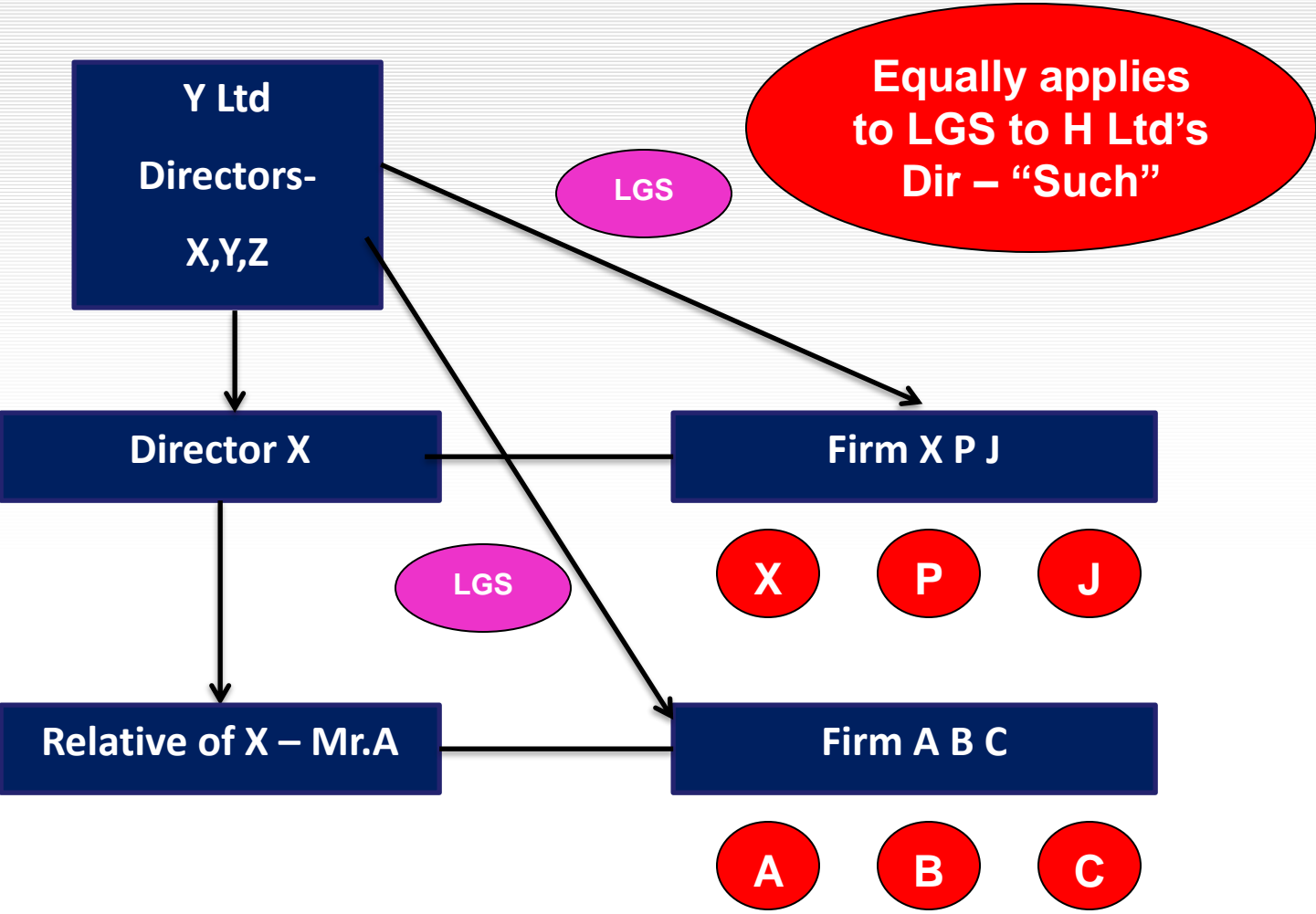
# Partner or Relative of Director of which Company ?



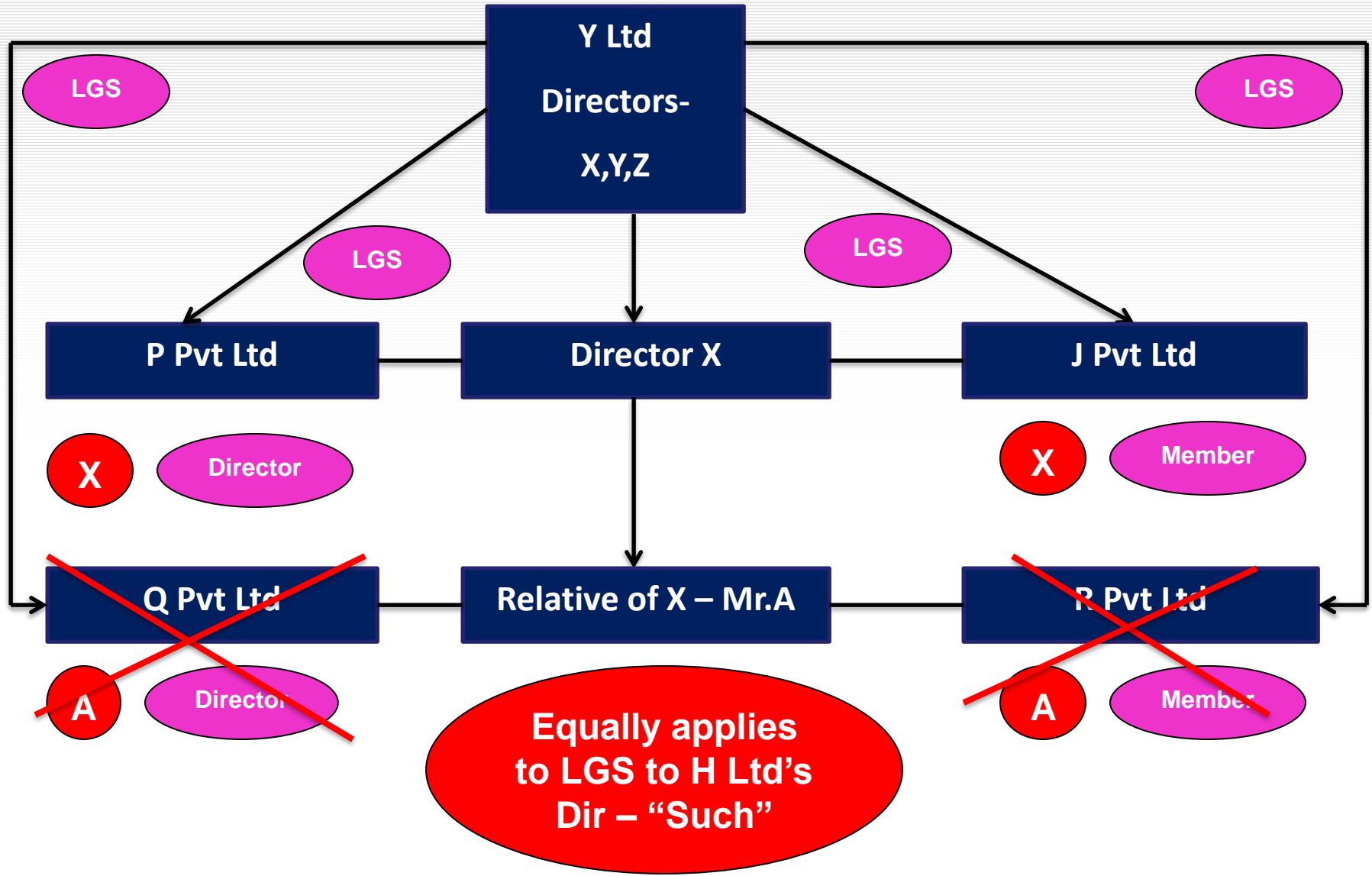
## Interpretation of the word “Such”

- ✓ The Supreme court in **Ombalika Das and Hulsia Shaw (2002) 4SCC 539** had occasion to explain the intent in the usage of the adjective “such” in legal parlance.
- ✓ The Apex Court opined that the **adjective “such” when prefixed to a noun has to be read in the same sense as is attributable to it in the preceding part of the sentence.** Going by this analogy, it may be stated that a company cannot advance loan or provide security or guarantee to a company limited by shares, in which more than 25% of the voting rights is exercised by the director(s) of the lending company or either singly or together with two or more Directors.
- ✓ Indirect holdings through relative, firms etc. shall not be considered as the above Clause (d) clearly states that the voting power shall be exercised by “such director” or by “such directors”.

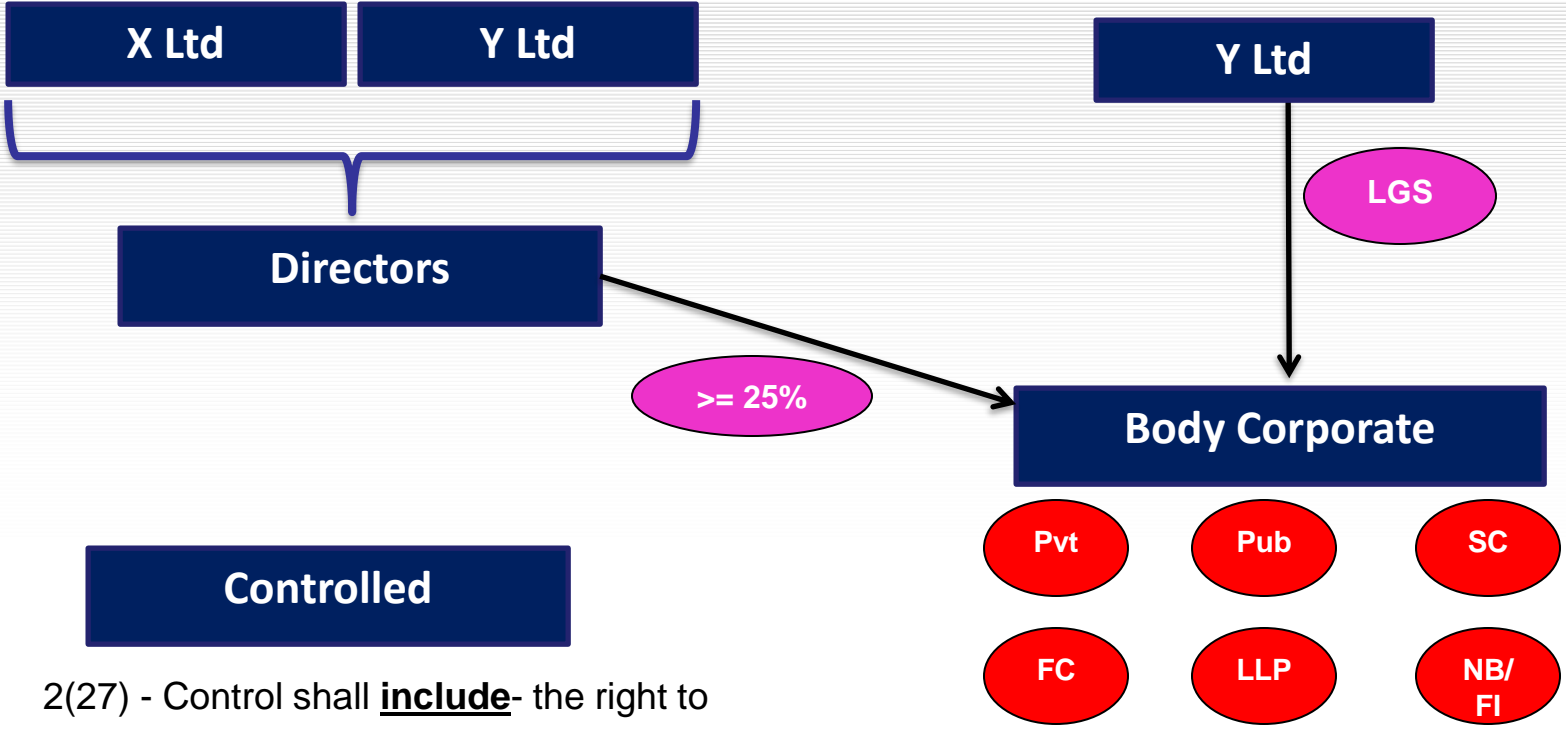
# any firm in which such director or a relative is a partner



# any Private company in which such dir is a dir or member



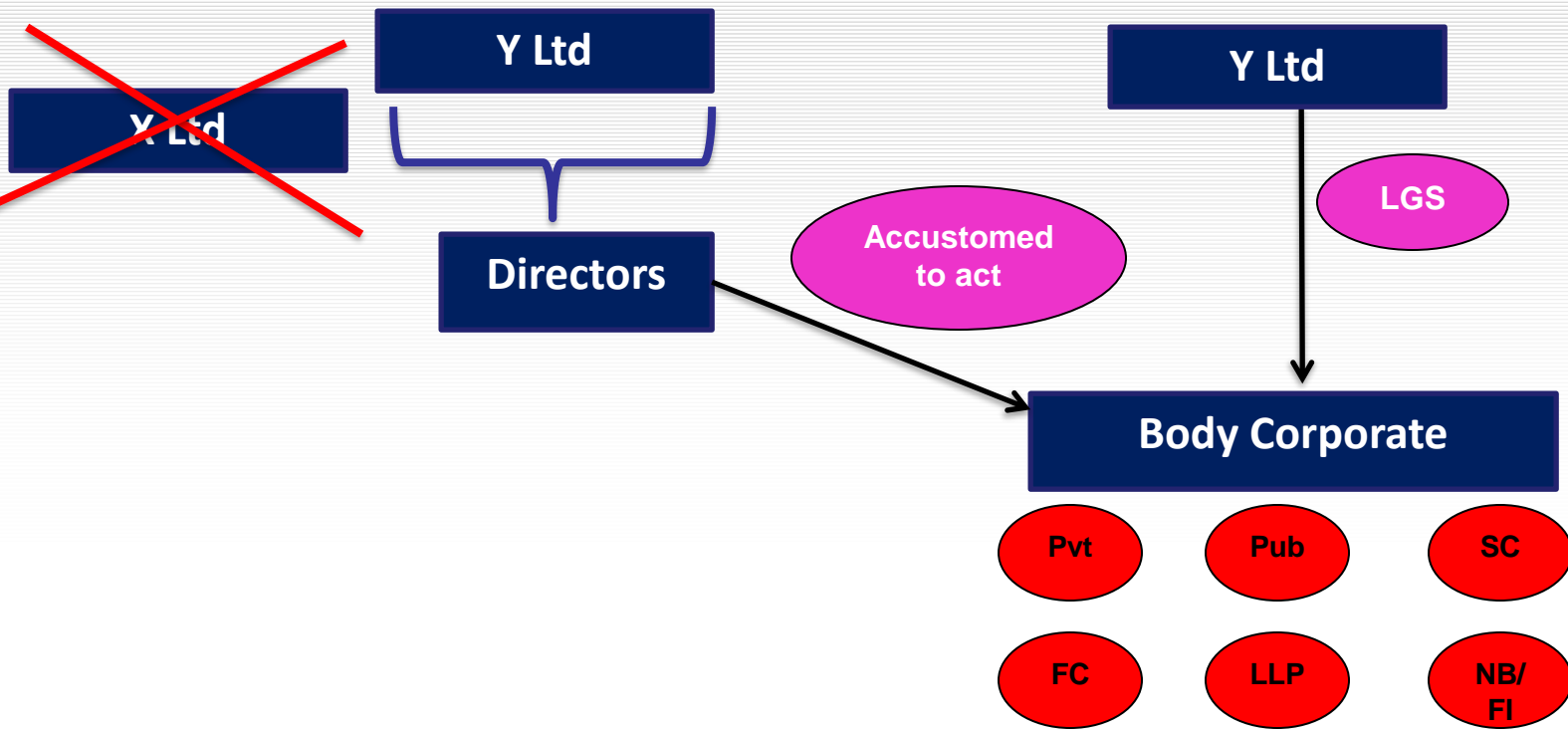
# any Body Corp where $\geq 25\%$ Voting power held



## Controlled

2(27) - Control shall **include**- the right to  
- appoint majority of the directors  
- to control the management or policy  
- by virtue of their **shareholding or management rights or shareholders agreements or voting agreements**

# any Body Corp in which BOD accustomed to Act



## Loans to Directors – Section 185

- ✓ It must be established that the directors of the borrower company do not exercise any discretion or judgment of their own, but act in accordance with the directions of the director(s)/Board of the Lender Company. It would be appropriate at this juncture to refer to a decision in **Hydrodam(Corby) Ltd. Re, (1994)**, where it was **held that where a parent company gave its sanction to a subsidiary for the disposal of the subsidiary's assets, this would not make the parent company a shadow director of the subsidiary.** The sanction was given by the holding company in the capacity of a majority shareholder and not a controller from behind. **As long as the decision was made by the directors of the subsidiary, exercising their own independent discretion and judgment, and the parent company only approved or authorized the decision, the parent company would not be considered as a shadow director.**
- ✓ The decision of the Bench in Secretary of State for Trade and Industry Vs. Becker (2003) 1 BCLC 555, that, to show that a person is a shadow director, it must be proved that **de-jure directors followed a consistent pattern of compliance with the instructions of the shadow director**

# Loans to Directors – Section 185

## Indirect loans - covers what?

- ✓ No “round-tripping” .Any form of subterfuge to be avoided
- ✓ 1. Loan to a Trust/HUF - will it attract sec 185? - Loans or advances to a trust in which directors are trustees / beneficiaries or to a HUF in which the director is a karta / member are not covered within the 7 parameters of section 185. It cannot be even called as “indirect loans”
- ✓ 2. Quasi loans - will it attract 185? - When a company pays money for the director to a third person in such circumstances that the director becomes liable to reimburse the company; it is a quasi-loan to a director. Such a transaction does not constitute even as indirect loan.
- ✓ 3. The word “indirectly” can be extended to cover only the “agents” of the persons specified in section 185.

## Scope of Guarantees/securities covered

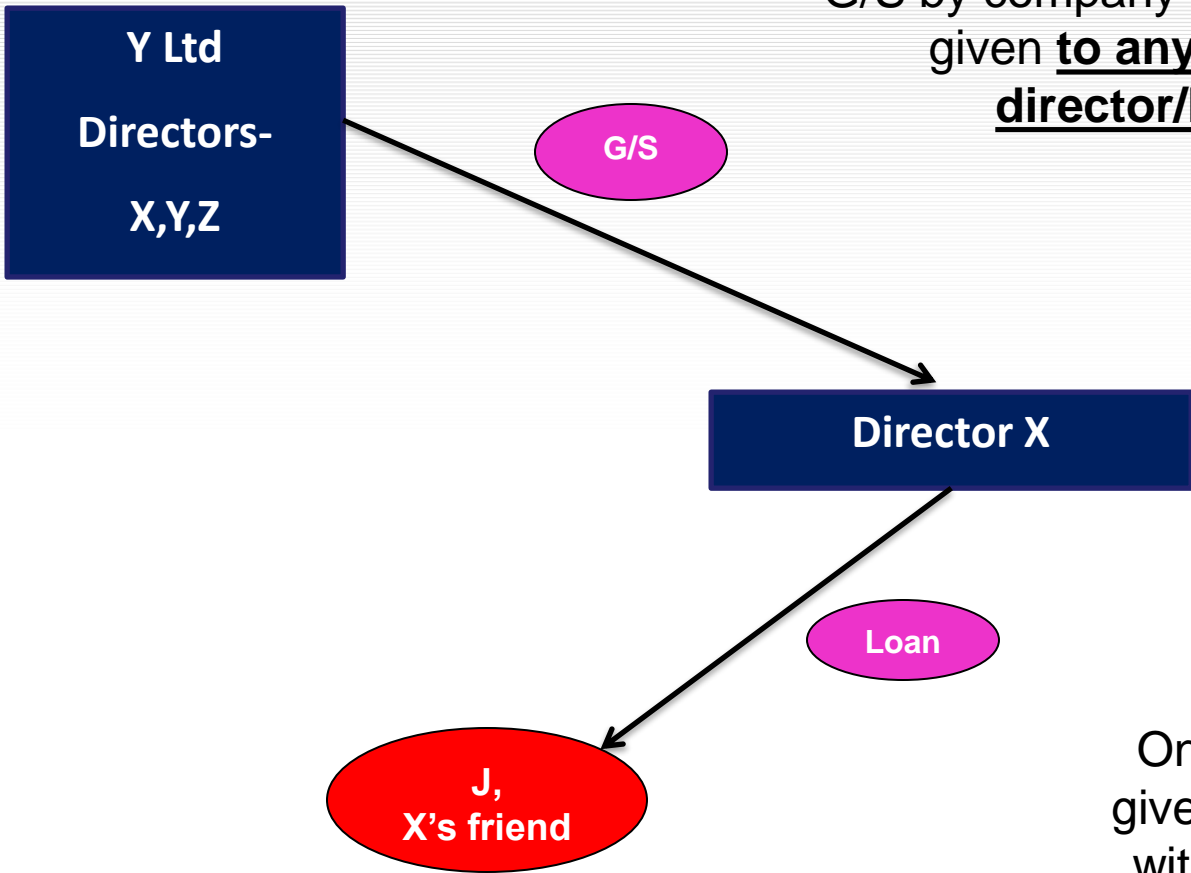
Any guarantee/security not involving transaction of lending/borrowing would not attract this section including, performance guarantees given to third parties guarantees against advance received for goods/project.

(1) Co	→	G/S	→	Sp. Person	→	Loan	→	Sp. Person
(2) Co	→	G/S	→	Person	→	Loan	→	Sp. Person
(3) Co	→	G/S	→	Sp. Person	→	Loan	→	Person
✓ ✓ (4) Co	→	G/S	→	Person	→	Loan	→	Person

# Guarantee/Security

**S.295** – G/S by company in connection with a loan given by any other person to a director/Interested party

G/S by company In connection with a loan given to any other person by a director/Interested party



**Lacuna due to wording**

## **S.185**

Only covers G/S by company given to outsiders in connection with a loan taken by director

# Loans to Directors – Section 185

## Supply of goods to Director on credit - will it attract section 185?

- ✓ 1. The answer depends on facts of the case.
- ✓ 2. It has to be found out in each case whether the sale on credit was a genuine credit sale or a loan disguised as a credit sale.
- ✓ 3. Such transaction may look like ordinary trade dealings, but will attract sec 185, if the intention was to give accommodation in that manner.

## Loans to Directors – Section 185

**Traveling advance/conveyance advance/salary advance to Director - will it attract section 185?**

- ✓ 1. The answer depends on facts of the case.
- ✓ 2. It has to be found out in each case whether the advance was a genuine advance or a loan disguised as a advance.
- ✓ 3. In M.R. Electrical Components Ltd. case a company had given an advance of Rs. 5,000/- to MD's wife who was employed by the company on a monthly salary.
- ✓ 4. The High court held that merely because the beneficiary, happened also to be the wife of a director could not justify that an offence had been committed.

## Loans to Directors – Section 185

5. The court had to find out in each case whether the salary advance was a genuine salary advance or a loan disguised as a salary advance and for this purpose, facts of the case shall be considered and in particular the following:

- ✓ - Whether the beneficiary is a bona fide employee.
- ✓ - Whether the advance falls in the general scheme of advances given by the company to other employees.
- ✓ - Whether the amount paid is disproportionate to the salary of the employee.
- ✓ - The conditions of repayment, like the rate of interest.
  - Whether there was laxity in the recovery of advance.
- ✓ - What is the capacity of the person receiving the advance.

# Loans to Directors – Section 185

## Rental advance & section 185

- ✓ Payment of rental advance by the company to the landlord to secure accommodation for MD will not attract section 185 because
- ✓ 1. The company has not given any deposit to the MD. The amount deposited with the landlord cannot be said to be an ‘indirect loan’, unless such deposit is diverted by the landlord to the MD.
- ✓ 2. It is a usual practice to give a security deposit to the landlord when a rental agreement is entered into. Thus, the security deposit is on account of bonafide business considerations.
- ✓ 3. It is of no concern of the MD as to the terms on which the company secures residential accommodation for him.
- ✓ 4. It is the company and not the director who has entered into the lease agreement. Therefore, the company can at any time use the accommodation for any other purpose and the MD will have to vacate it, as and when desired by the company.

# Loans to Directors – Section 185

## Loan and debt

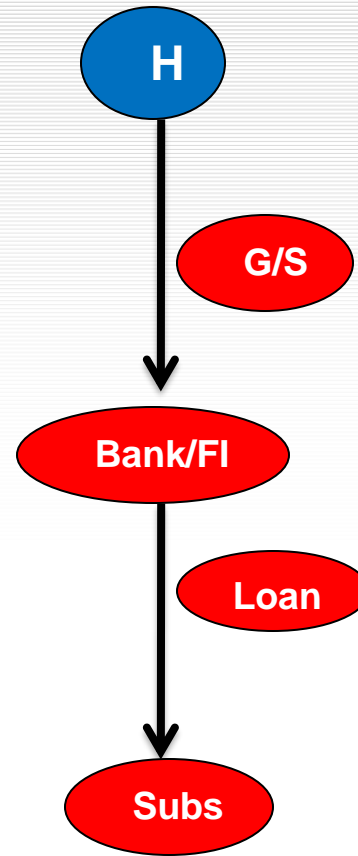
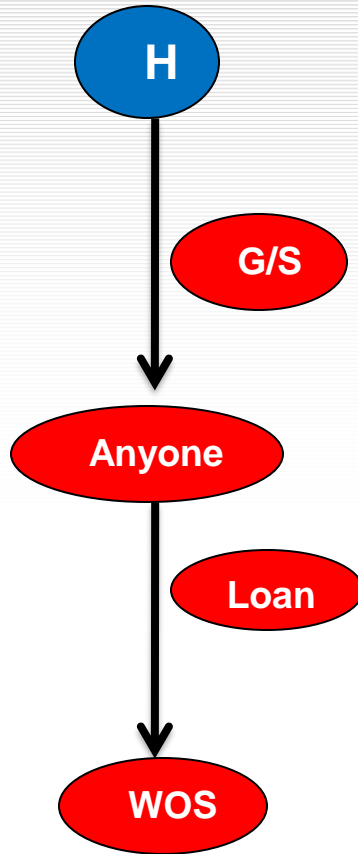
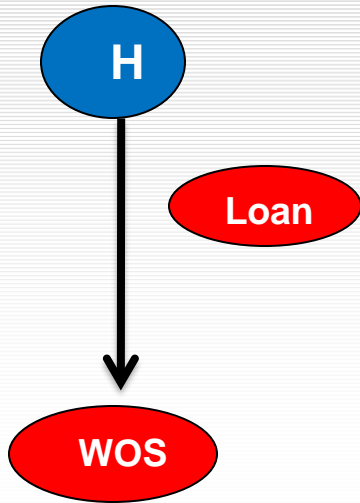
- ✓ 1. Where a company sells a flat to one of its directors and receives half the price in cash and the balance in installments, the transaction amounts to a credit sale; it does not amount to even an 'indirect loan'.
- ✓ 2. The word 'indirect' cannot be read as converting what is not a loan into a loan.
- ✓ 3. Therefore, the Court held that there was no contravention of section 295 (presently sec 185). [Dr. Freddie Ardeshir Mehta v. Union of India, 1991].

## Loans to Directors – Section 185

- (3) Nothing contained in sub-sections (1) and (2) shall apply to—
- (a) the giving **of any loan** to a managing or whole-time director—
    - (i) as a part of the **conditions of service** extended by the company to all its employees; or
    - (ii) pursuant to any **scheme approved by the members** by a special resolution; or
  - (b) a company which **in the ordinary course of its business** provides loans or gives guarantees or securities for the due repayment of any loan and in respect of such loans an interest is charged at a rate not less than the rate of prevailing yield of one year, three years, five years or ten years Government security closest to the tenor of the loan; or
  - (c) any loan made by a holding company to its wholly owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company; or
  - (d) any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company:

# Significant Amendments

## Companies (Amendment) Act 2017



# Compliance Action Point

## Loans Given – A breather for Private Companies

### Notification – 05/06/2015

Shall not apply to a private company -

(a) in whose share capital no body corporate has invested any money;

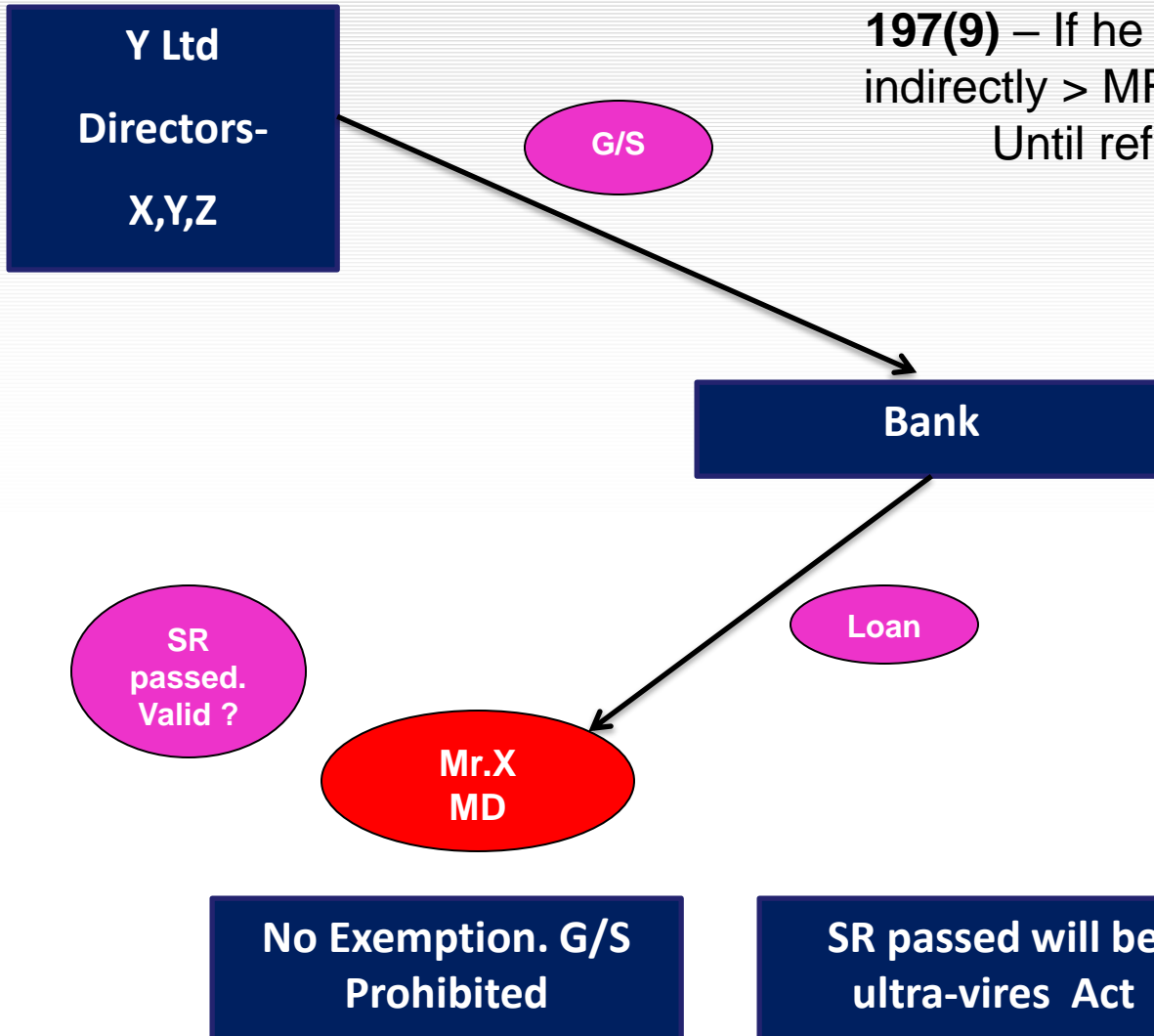
(b) if the borrowings of such a company from banks/FI/BC is

**<2 times PUC or 50 Crores- WIL**

(c) such a company has **no default in repayment** of such borrowings subsisting at the time of making transactions under this section.

## Lacuna – MD Provisions

**197(9)** – If he receives money directly or indirectly > MR ,then refund to company.  
Until refund , hold it in trust !



# Loans to Directors – Section 185

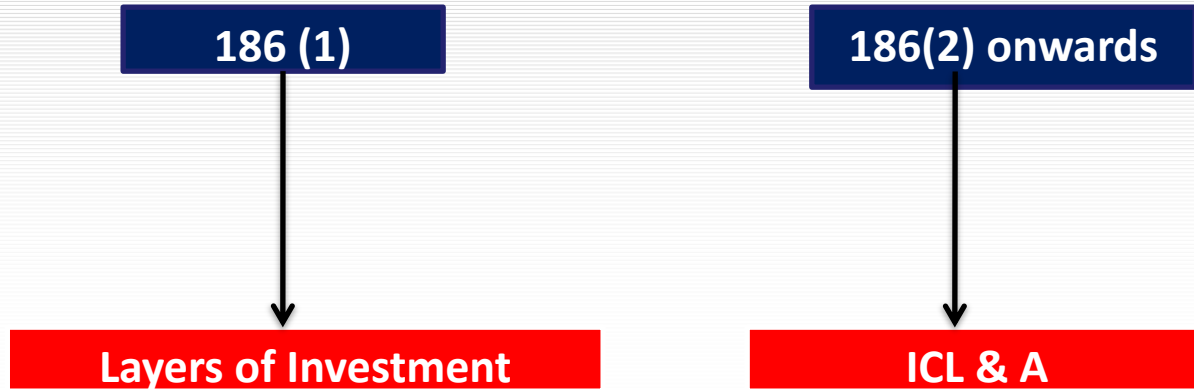
## Implications and issues

- ✓ 1. Loans to Directors and others - banned - no powers even for CG.
  - ✓ 2. Ordinary course of business - refers to only 'finance and investment companies'
  - ✓ 3. Company also punishable.
  - ✓ 4. Only company and director/interested party liable
  - ✓ 5. Repayment of loan - no reduction in imprisonment.
  - ✓ 6. Violation of this section - no vacation of office of director.
  - ✓ 7. What about repayment of loan to the company? How does punishment serve the purpose?
  - ✓ 8. Section could have defined 'loan' for conceptual clarity - to distinguish from advance, deposit, debt. .. etc.
- 
- ✓ **Subsequent applicability of Sec 185**
  - ✓ If the manager, secretary or employees are subsequently appointed as Directors this section will not apply since, the applicability of this section has to be seen on transaction date.



# INTER-CORPORATE LOANS AND ADVANCES – SEC 186

# Section 186 break-up



Section	Companies (Amendment) Act 2017
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Section 90 – Significant Beneficial ownership of shares

*Basic Terms to understand the Concept*

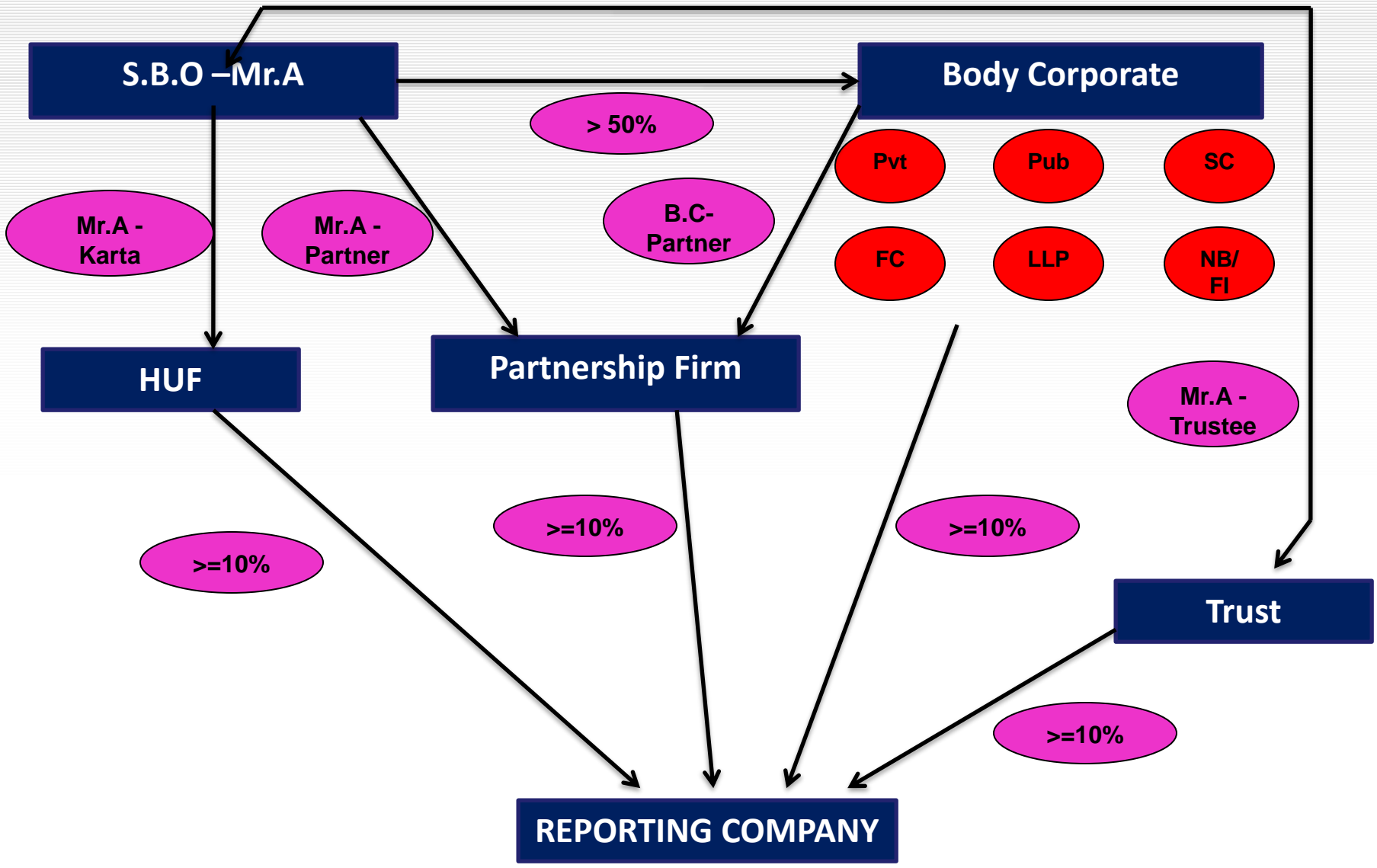
**FIRST CHECK:** *SBO is should be Natural Person*

**SECOND CHECK:** *Such person holds at least 10% of shares/ voting right / Dividend / control etc. (Indirect along with direct holding)*

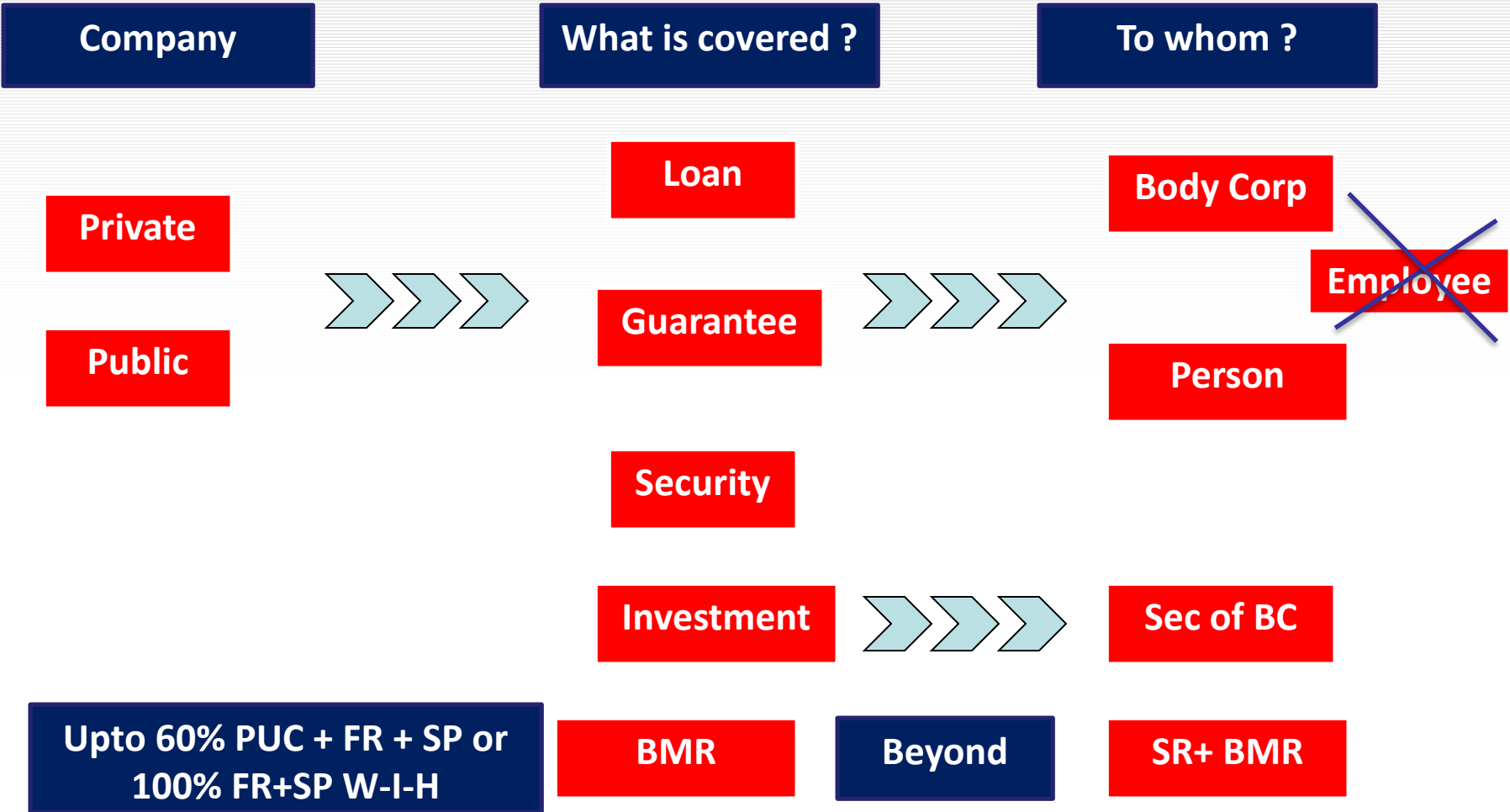
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**THIRD CHECK:** *There should be Indirect Holding*

# INDIRECT HOLDING



# Section 186 break-up



# Loan and investment by company Sec 186

1.No company shall directly or indirectly

- ✓ give any loan to any person or other body corporate;
- ✓ give any guarantee or provide security in connection with a loan to any other body corporate or person; and
- ✓ acquire by way of subscription, purchase or otherwise, the securities of any other body corporate,

exceeding 60% of its paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account, whichever is more.

2. Where the giving of any loan or guarantee or providing any security or the acquisition exceeds the limits specified, prior special resolution passed at a general meeting shall be necessary.

# Loan and investment by company Sec 186

## Summary of sub section 1 and 2

- ✓ 1. The Board of directors may give loan, guarantee, security or invest, upto 60% of its paid-up share capital, free reserves and securities premium or 100% of its free reserves and securities premium, whichever is more.
- ✓ 2. Where, a company exceeds the aforesaid limits, prior special resolution will be required to be passed in a general meeting.
- ✓ 3. Receiver - Body corporate - in case of investments, the giver should be a company; the receiver can be body corporate or person. Thus, Body corporate covers companies, statutory corporations and body corporate.

# Loan and investment by company Sec 186

## Indirectly

- ✓ 1. The word 'indirectly' refers to any person who holds the securities in trust or for its benefit or on its account or as a nominee of the investing company
- ✓ 2. Loan **does not** include debentures and deposits
- ✓ 3. Under the previous act, loans included debentures or deposits made by one company to another. The same stands omitted in the new Act.
- ✓ Inter corporate debentures **NOT to be considered as loans**

# Loan and investment by company Sec 186

## Indirectly

- ✓ Inter corporate deposits are not deposits as per Rule 2(1)(vi) of Companies(Acceptance of Deposits) Rules. Hence **it may be entered in the calculation of 60%/100% limits, but as a loan**
- ✓ Inter-corporate advances for supply of goods ? Are they loans ?

Corporate advances which are genuinely given for the purposes of trade which are subject to adjustments against future supplies are not to be bracketed as loans under S.186 provided it is set off within 365 days.

However, if “trade advance” route is abused to rope in payments which are intended covertly to be provided as “loans” – then 186

# Loan and investment by company Sec 186

## Scope of guarantees / securities covered

- ✓ 1. The company giving a guarantee or security to a person/Body corporate to enable them to give a loan to any person/Body corporate will attract the section.
- ✓ 2. Sec 186 is not attracted if guarantee or security given does not involve lending and borrowing of money.
- ✓ 3. Thus 186 will not attract,
  - performance guarantees,
  - guarantees against advance for supply of goods.
- ✓ 4. Acquisition of Securities of Body Corporate
- ✓ 5. Securities can be acquired through subscription, purchase or otherwise

# Loan and investment by company Sec 186

## 6. Securities under SCRA includes:

- Shares, scrip's, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in any incorporated company or other body corporate.
- Derivative
- Units or another instrument issued by any collective investment scheme to the investors in such schemes.
- Government securities.
- Security receipt as defined in the Securitization Act, 2002.
- Such other instruments as may be declared by the Central Government to be securities.
- Rights or interest in securities.

7. Sec 186 will not apply to investments in mutual funds run by trusts, which are not bodies corporate.

8. Investment made in Govt securities, though covered in "securities" are not issued by a body corporate - sec 186 will not apply.

9. Loans and investments in securities of a foreign company will attract sec 186.

# Loan and investment by company Sec 186

## Free reserves 2(43)

Free reserves means those reserves which, as per the latest audited Balance Sheet are free for distribution as dividend

### Free reserves thus includes

- ✓ - Profit and Loss Account credit balance
- ✓ - General reserves
- ✓ - Dividend equalization reserve
- ✓ - **Securities premium account**

### Free reserves does not include

- ✓ - Capital redemption reserve
- ✓ - Sinking fund.
- ✓ - Provision for taxation
- ✓ - Fixed assets revaluation reserve
- ✓ - Capital reserves.
- ✓ - Share application money

# Loan and investment by company Sec 186

## Paid-up share capital

- ✓ - Both equity and preference share capital will be taken into account.
- ✓ - Paid-up share capital also should be computed as per the latest audited Balance Sheet.
- ✓ 3. Share application money has been expressly excluded from the definition of free reserves; also does not form part of paid up share capital.

## Section 8 companies

- ✓ 1. Section 8 companies not having share capital, see 186, can be computed in relation to free reserves alone. - DCA clarification

# Loan and investment by company Sec 186

## Calculation of problems - ABCD principle

- ✓ 1.  $A = 60\%/100\%$  Board limit.
- ✓ 2.  $B =$  Loans, Guarantees, Securities and Investments already made.
- ✓ 3.  $C = A - B =$  Further Loans, Guarantees, Securities and Investments, Board itself can make.
- ✓ 4.  $D =$  Proposal.
  - ✓ a. If  $D < C$ , Board itself can approve
  - ✓ b. If  $D > C$ , Prior Special resolution required.

## Disclosure in financial statements

- ✓ The company shall disclose to the members in the financial statement the full particulars of the loans given, investment made or guarantee given or security provided and the purpose for which the loan or guarantee or security is proposed to be utilized by the recipient of the loan or guarantee or security.

# Loan and investment by company Sec 186

## Board meeting & Unanimous approval

- ✓ 1. No investment shall be made or loan or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all the directors present at the meeting and the prior approval of the public financial institution concerned where any term loan is subsisting, is obtained:
- ✓ 2. The resolution is to be passed at a meeting of the Board with consent of all the directors present. **G.Sec yield of 1 year, 3 year, 5 year, 10 year to be maintained**
- ✓ 3. Such unanimous consent at the Board meeting will apply in both the cases
  - Within 60%/100% limits and
  - Beyond the above limits

## Loan and investment by company Sec 186

- ✓ 4. However, prior approval of a public financial institution shall not be required where the aggregate of the loan/investments/guarantee/security so far made, together with the proposal does not exceed the Board limits (60%/100%) and there is no default in repayment of loan installments or payment of interest thereon as per the terms and conditions of such loan to the public financial Institution.
  
- ✓ 5. No company registered under section 12 of the SEBI Act, 1992 and also covered under such class of companies notified by CG in consultation with SEBI, shall take any inter-corporate loan or deposits, in excess of the limits prescribed under the regulations applicable to such company, pursuant to which it has obtained certificate of registration from SEBI

# Loan and investment by company Sec 186

<b>LGSI Limits</b>	<b>Default from PFI</b>	<b>Approvals</b>
Less than 60/100 %	Yes	<b>Prior PFI + BMR+ Unanimous</b>
Less than 60/100 %	No	<b>No PFI + BMR + Unanimous</b>
More than 60/100 %	Yes	<b>Prior PFI + Prior SR + BMR + Unanimous + MGT 14</b>
More than 60/100 %	No	<b>Prior PFI + Prior SR + BMR + Unanimous + MGT 14</b>

# Loan and investment by company Sec 186

## Case where special resolution not required

- ✓ 1. Special resolution shall not be required where the loan or guarantee or security is given by the company to its Wholly owned subsidiary or a Joint venture company or for investments by the company to its Wholly owned subsidiary.
- ✓ 2. However such details shall be disclosed in financial statements of the company

## Rate of interest

- ✓ 1. No loan shall be given under this section at a rate of interest lower than the prevailing yield of 1 year, 3 year, 5 year or 10 year Government Security closest to the tenor of the loan.

# Loan and investment by company Sec 186

## Default in repayment of deposits

- ✓ No company which is in default of the repayment of any deposits accepted before or after the commencement of this Act or in payment of interest thereon, shall give any loan or give any guarantee or provide any security or make an acquisition till such default is subsisting.

## Register of Loans etc.

- ✓ 1. Every company giving loan or giving guarantee or providing security or making an acquisition shall, from the date of its registration, maintain a register in **Form No. MBP 2** and enter the particulars specified therein. Entries in the register shall be made chronologically in respect of each such transaction within 7 days.
- ✓ 2. The register shall be kept at the registered office and shall be preserved permanently and shall be kept in the custody of the company secretary or any authorised person.

# Loan and investment by company Sec 186

- ✓ 3. Entries in the register shall be authenticated by the Company Secretary or by any other person authorized by the Board for the purpose.
- ✓ 4. The register can be maintained manually or in electronic mode.
- ✓ 5. The register shall be kept at the registered office of the company and shall be open to inspection at such office; and extracts from the register may be furnished to any member on payment of Rs. 10/- for each page.

## Non-applicability of the section

This section will not apply to a loan, guarantee given or security provided by

- ✓ 1. a banking company or
- ✓ 2. an insurance company or
- ✓ 3. a housing finance company in the ordinary course of its business or

# Loan and investment by company Sec 186

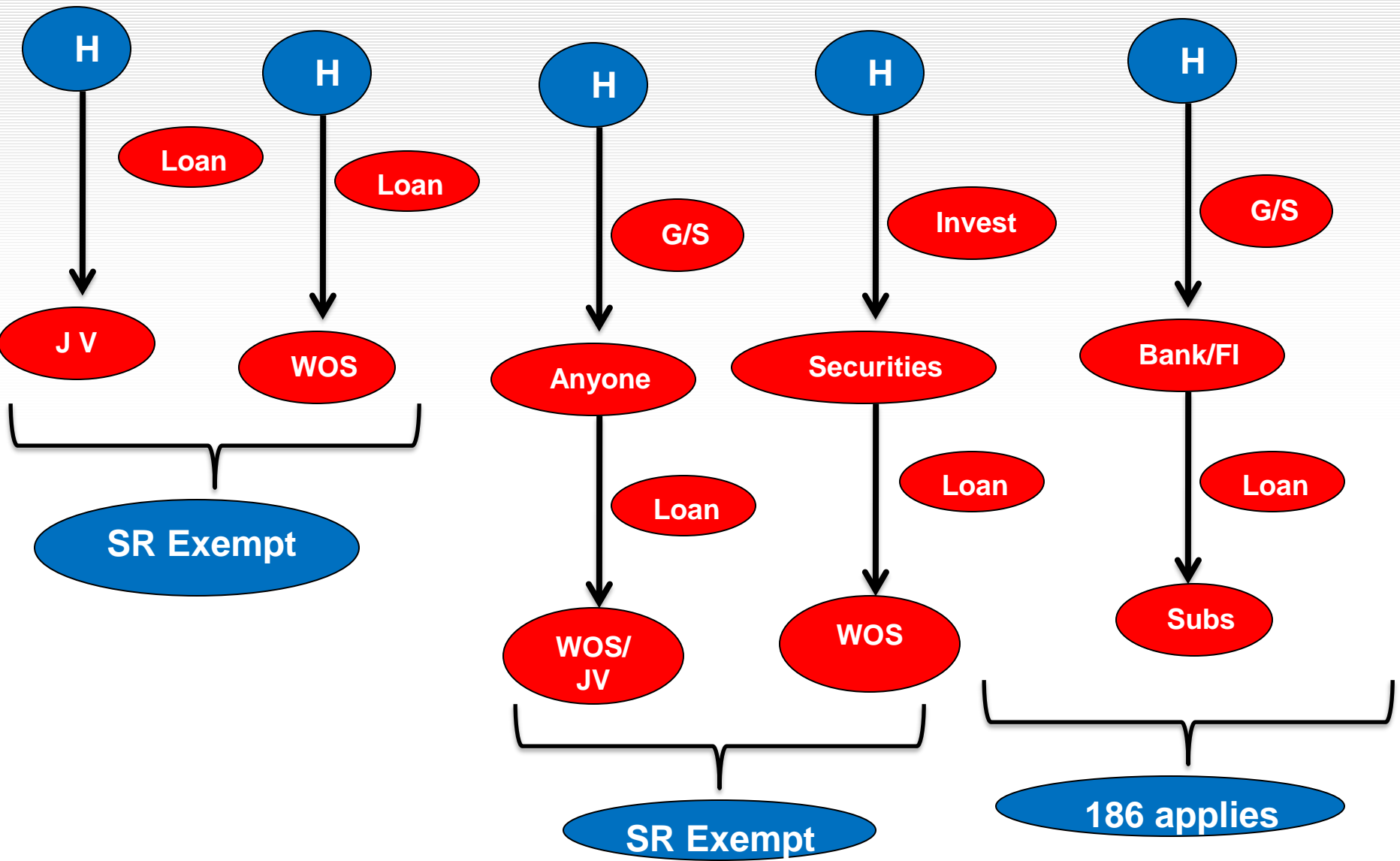
4. a company engaged in the business of financing of companies (NBFC company registered with RBI) or
5. of providing infrastructural facilities;
6. to any acquisition -
  - ✓ - made by an NBFC company registered with RBI whose principal business is acquisition of securities, in respect of its investment and lending activities;
  - ✓ - made by a company whose principal business is the acquisition of securities;
  - ✓ - of right shares allotted under section 62.

**Exemption to subsidiary company/joint ventures – conditions thereof:** As per Rule 11(1) of the Companies (Meetings of Board and Its Powers) Rules, 2014:

- ✓ Where a **loan or guarantee** is given or where a **security** has been provided by a company to its:
  - (i) wholly owned subsidiary company, or
  - (ii) a joint venture company, or
- ✓ Where an **acquisition is made by a holding company**, by way of subscription, purchase or otherwise of, the securities of its wholly owned subsidiary company, the requirement of sub-section (3) of section 186 shall not apply.

# Significant Amendments

## Companies (Amendment) Act 2017



## Loan and investment by company Sec 186

- ✓ ***Section 186 shall not apply to —***
  - (a) a Government company engaged in defence production;***
  - (b) a Government company, other than a listed company, in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before making any loan or giving any guarantee or providing any security or making any investment under the section.***

***vide Notification F No 1/2/2014-CL.V dated 5th June 2015.***

# Loan and investment by company Sec 186

## Exemptions - some issues

- ✓ In case of rights issue, the rule shall be, once exempted, always exempted. The exempted investments are to be excluded from calculation in considering the limits (excluded from the B figure itself)

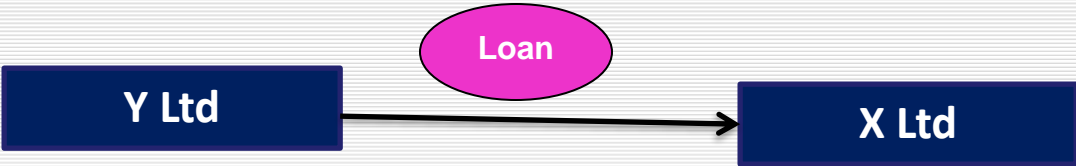
## Postal ballot

- ✓ Postal Ballot is mandatory for passing special resolution in the case of a listed company for transacting any business in excess of the ceiling limits of 60%/100% as specified.

## Power to make inter corporate loans and investments cannot be delegated

- ✓ 1. Section 179(3) authorizes the Board to delegate the power to make loans and investments.
- ✓ 2. However, under section 186, the power to make inter corporate loans and investments cannot be delegated by a public company

# 186 SR Limit



SC	100L
FR	100L
Unsec Crs	30L

60% of 200L  
=120L  
Or 100L  
W-i-h

Beyond 120L = SR

Proposed loan = 210 Lakhs

Would passing SR be valid ?

# Loan and investment by company Sec 186

## Department clarification

- ✓ 1. Special resolution, for loans/investment much beyond the net worth should not be passed by the companies.
- ✓ 2. Thus borrowed funds cannot be used for inter corporate loans and investments.
- ✓ 3. The explanatory statement should indicate, the specific securities in which it is proposed to invest. En-block approval should normally be avoided.
- ✓ 4. Thus company wise, investment wise, separate resolution must be passed.

# Loan and investment by company Sec 186

## Investments not to exceed two layers

- ✓ 1. A company shall make investment through not more than two layers of investment companies:
  
- ✓ 2. However, the above restriction shall not affect,-
  - a company from acquiring any other company incorporated outside India if such other company has investment subsidiaries beyond two layers as per the laws of such country;
  - a subsidiary company from having any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force.

# Loan and investment by company Sec 186

## Intent behind the restriction on number of layers

- ✓ The JJ IRani Committee Report dated May 31, 2005 was highly critical of putting any restriction on the number of subsidiary companies. It rightly pointed out **that such a restriction could cripple investment** by Indian companies abroad and instead a mechanism based on transparent board processes and disclosures under close supervision of the regulator should be prescribed, for listed companies. This resulted in clause 164 of the Companies Bill, 2009 being drafted similar to section 372A of Companies Act, 1956
- ✓ However, the Standing Committee on Finance in its report on Companies Bill, 2009 suggested that each company **should have only one investment company and that no subsidiary should have further subsidiaries**. The reason for such a stand was that the mechanism of inter-corporate loans/investments and resultant transfer of funds to subsidiaries etc. should remain only an instrument of corporate growth rather than a method for diversion of funds from a healthy enterprise

# Loan and investment by company Sec 186

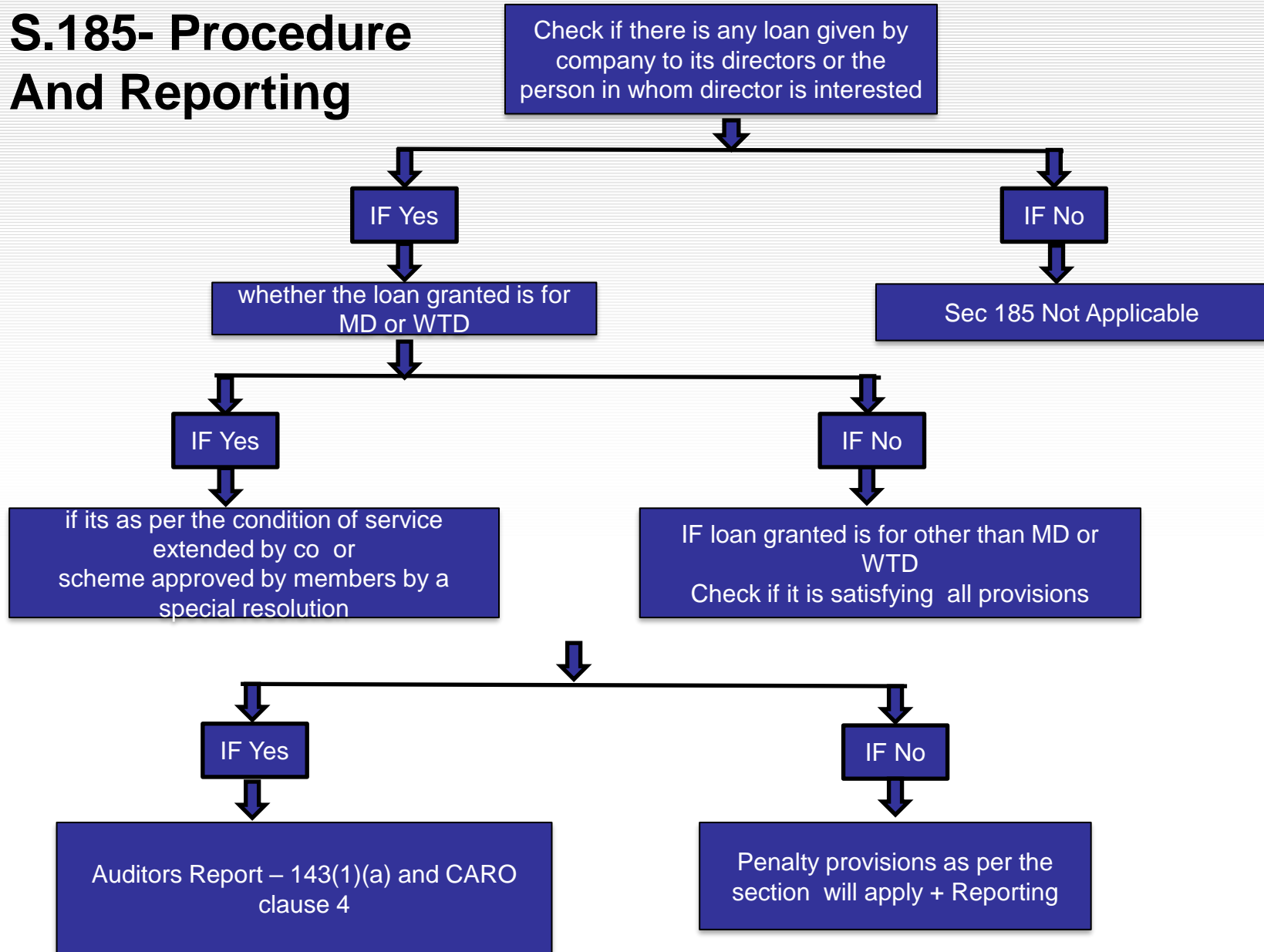
## Section 186 - Procedure

- ✓ 1. Matter to be considered at Board level.
- ✓ 2. Resolution at the meeting of the Board.
- ✓ 3. Unanimous approval of all the directors.
- ✓ 4. Convening of EGM.
- ✓ 5. Notice to specify the necessary details.
- ✓ 6. Postal ballot for listed companies.
- ✓ 7. Approval by special resolution.
- ✓ 8. Filing of special resolution with ROC.
- ✓ 9. Inform stock exchanges as per listing agreement.
- ✓ 10. Rate of interest not less than Govt securities rate.
- ✓ 11. Approval of financial institutions.
- ✓ 12. No default in repayment of deposits.
- ✓ 13. Maintenance of Register
- ✓ 14. Financial statements must specify details.



# Audit Procedures and Reporting – S.185 and S.186

# S.185- Procedure And Reporting



## S.185 Procedures and Reporting

### 143(1)(a)

(a) whether **loans and advances made** by the company on the basis of **security have been properly secured** and whether the terms on which they have been made are **prejudicial to the interests of the company or its members**

# Reporting Requirements

- This clause applies to loans and advances given by the company during the financial year under audit, whether they are outstanding on the date of the Balance Sheet or not.
- Distinction is obviously intended to be made between “loans and advances” and “deposits”
- “Security” for this purpose would include any movable or immovable property, whether belonging to the borrower or not, of which either physical possession or over which a legally effective charge is given to lender.
- Applies to all loans and advances made on the **basis of security / charge, whether movable or immovable, whether or not belonging to the borrower.**

# Reporting Requirements

- Company's right to enforce such right shall be examined in detail.

Type of Security	Documents to be verified
Shares and debentures	Duly transferred in the name of the Company
Government securities, and other securities, documents of title which are transferable by endorsement and delivery, e.g. Bills of Lading, and Railway Receipts	Duly endorsed
Immovable property	Registered mortgage deed Or Equitable mortgage ( as appropriate)

# Reporting Requirements

Life Insurance Policy	Assignment in favor of lender, duly registered with the Insurance company
Pledge	Appropriate record of goods held
Hypothecation of goods	Deed of hypothecation

## **S.186 Disclosure and Reporting**

### **Disclosure – Board's Report**

**134(3)(g) particulars of loans, guarantees or investments under section 186;**

**MBP-2**

# Loan and investment by company Sec 186

## FORM MBP.2

Register of loans, guarantee, security and acquisition made by the company

*[Pursuant to section 186(9) & rule 12(1)]*

Nature of transaction (whether loan/guarantee/security/acquisition)	Date of making loan/acquisition/giving guarantee/providing security	Name and address of the person or body corporate to whom it is made or given or whose securities have been acquired (Listed/Unlisted entities)	Amount of loan/security/acquisition/guarantee	Time period for which it is made/given
(1)	(2)	(3)	(4)	(5)

# Loan and investment by company Sec 186

Purpose of loan/acquisition/guarantee/security	% of loan/acquisition/exposure on guarantee/security provided to the paid up capital, free reserves and securities premium account and % of free reserves and securities premium	Date of passing Board resolution	Date of passing special resolution, if required	For loans	
				Rate of interest	Date of maturity
(6)	(7)	(8)	(9)	(10)	(11)
For acquisitions					

Number and kind of securities	Nominal value and paid up value	Cost of acquisition (in case of securities how the purchased price was arrived at)	Date of selling of investment	Selling price (how the price was arrived at)	Signatures and Remarks
(12)	(13)	(14)	(15)	(16)	(17)

Signature:

MD/Director/Secretary/Whole time Director

Place:

Date:

## Clause 3 – CARO 2020 ADDITIONS

Whether during the year the company has provided loans or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate-

- (A) the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to subsidiaries, joint ventures and associates.
- (B) (B) the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to parties other than subsidiaries, joint ventures and associates

## Clause 3 – CARO 2020 ADDITIONS

Whether any loan or advance in the nature of loan granted which has fallen due during the year, has been renewed or extended or fresh loans granted to settle the overdues of existing loans given to the same parties; If so, specify the aggregate amount of such dues renewed or extended or settled by fresh loans and the percentage of the aggregate to the total loans or advances in the nature of loans granted during the year. [Not applicable to companies whose principal business is to give loans];

## Clause 3 – CARO 2020 ADDITIONS

Whether the Company has granted any loans or advances in the nature of loans either repayable on demand or without specifying any terms or period of repayment; if so, specify the aggregate amount, percentage thereof to the total loans granted, aggregate amount of loans granted to Promoters, related parties as defined in 2(76)

## S.185 and 186 Disclosure and Reporting

### **CARO – Reporting : Clause 4**

*In respect of loans, investments, guarantees, and security whether provisions of section 185 and 186 of the Companies Act, 2013 have been complied with.*

*If not, provide the details thereof. [Paragraph 3(iv)]*

## S.185 and 186 Disclosure and Reporting

### ➤ Section 185 Compliance – Guidance Note on CARO-23/04/2016

(i) Obtain from the management the **details** of the directors or any other person in whom the director is interested + MBP-1 + S.189 Register

(ii) Obtain and check the details of the transactions carried out with such persons, including of any guarantee given and security provided

(iii) Further examine the details to find out whether any of the transaction is attracting the provisions of section 185 of the Act

## S.185 and 186 Disclosure and Reporting

### Section 185 Compliance – Guidance Note on CARO-23/04/2016

(iv) In case of transactions that are covered under the **exceptions as provided under section 185**, the auditor should obtain the necessary evidence in support of such exception.

(v) The auditor should report the **nature of non-compliance**, the maximum amount outstanding during the year and the amount outstanding as at the balance sheet date in respect of

(i) the Directors; and

(ii) persons in whom directors are interested (specify the relationship with the Director concerned).

## S.185 and 186 Disclosure and Reporting

### Section 186 Compliance – Guidance Note on CARO-23/04/2016

- i. **Obtain details of LGSI** – During the year and opening balance
- ii. 60/100% limit – Whether BMR and/or SR is passed
- iii. Register as per MBP-2
- iv. For 186(2) exempted companies, restriction with regard to the investment through more than two layers of investment companies **would be applicable**. The auditor may ensure compliance accordingly.

***[186(11) – Nothing contained in this sub-section, except sub-section 1 ,shall apply to.....]***

# S.185 and 186 Disclosure and Reporting

Non-compliance may be reported incorporating following details:-

S.No.	Non-compliance of Section 186			Remarks, if any	
		Name of Company/ Party	Amount Involved		Balance as at Balance Sheet Date
1.	Investment through more than two layers of investment companies				
2.	Loan given or guarantee given or security provided or acquisition of securities exceeding the limits without prior approval by means of a special resolution				
3.	Loan given at rate of interest lower than prescribed				
4.	Any other default				



# DISCLOSURE OF INTEREST – SEC 184

# Section 184 break-up

**184 (1)**



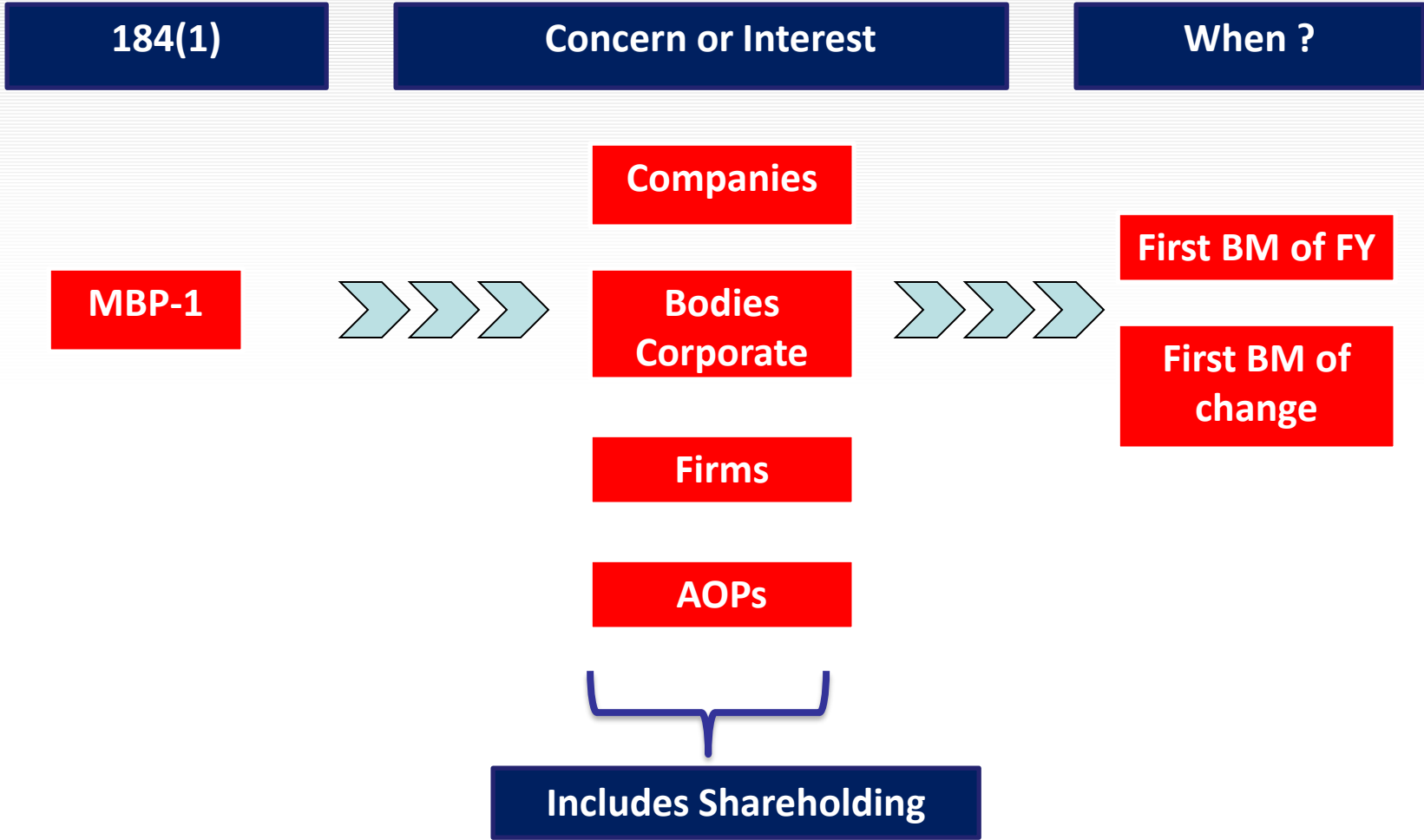
**General  
Disclosure**

**184(2)**



**Specific  
Disclosure**

# Section 184(1) – General Disclosure



# Disclosure of Interest – Section 184

## FORM MBP.1

### Notice of interest by director

[Pursuant to section 184 (1) and rule 9(1)]

To  
The Board of Directors  
..... Limited

Dear Sir(s)

I, ....., son/daughter/spouse of ....., resident of ....., being a director in the company hereby give notice of my interest or concern in the following company or companies, bodies corporate, firms or other association of individuals:-

I.

Sl No.	Names of the Companies/ bodies corporate/firms/ association of individuals	Nature of interest or concern/Change in interest or concern	Shareholding	Date on which interest or concern arose/changed

Signature:

MD/Director/Secretary/Whole time Director

Place:

Date:

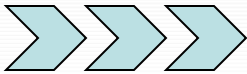
# Section 184(2) – Specific Disclosure

**184(2)**

**Nature of Concern or Interest**

**When ?**

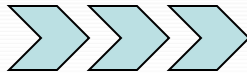
- Contract
- Arrangement
- Proposed Contract
- Proposed Arrangement



Bodies Corporate in which Dir hold >2%

Bodies Corporate in which Dir is a promoter/ CEO

Firm/Other in which Dir is a partner, owner, member



- BM where its discussed
- Next BM if he becomes interested later

## Disclosure of Interest – Section 184

- ✓ 1. Every director shall at the first Board Meeting, in which he participates as a director, and thereafter at the first Board meeting in every financial year or whenever there is any change in the disclosures already made, then at the first Board meeting held after such change, disclose his concern or interest in any company or companies or bodies corporate, firms, or other association of individuals which shall include the shareholding by giving a notice in writing in Form No. **MBP 1**.
  
- ✓ 2. It shall be the duty of the director giving notice of interest to cause it to be disclosed at the meeting held immediately after the date of the notice.

# Disclosure of Interest – Section 184

- ✓ 3. All such notices
  - shall be kept at the registered office
  - shall be preserved for a period of eight years from the end of the financial year to which it relates and
  - shall be kept in the custody of the company secretary or any other person authorized by the Board for the purpose.
  
- ✓ 4. 'Body corporate' includes Pvt company, Public company, Corporations and Foreign company.
  
- ✓ 5. 'Firm' includes not only 'partnerships', but also -sole proprietary concern, HUF, association of persons, etc.

# Disclosure of Interest – Section 184

## Points to ponder

- ✓ 1. Section 184(1) and 184(2) are two separate sub-sections with specific duties for directors.
- ✓ 2. In both the sub-sections, nature of concern and interest also to be disclosed.
- ✓ 3. In sec 184(1), Director's relatives interests need not be disclosed?
- ✓ 4. Sec 184( 1) disclosure is irrespective of contracts actually entered by the company with the related party.

# Disclosure of Interest – Section 184

## Interested Director - sec 2(49)

- ✓ “Interested director” means a director who is in any way, whether by himself or through any of his relatives or firm, body corporate or other association of individuals in which he or any of his relatives is a partner, director or a member, interested in a contract or arrangement, or proposed contract or arrangement, entered into or to be entered into by or on behalf of a company;

# Disclosure of Interest – Section 184

## Specific disclosure of interest - sec 184(2)

1. Every director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into
  - ✓ - with a body corporate in which such director or such director in association with any other director, holds more than 2% shareholding of that body corporate, or is a promoter, manager, CEO of that body corporate;
  - ✓ - with a firm or other entity in which, such director is a partner, owner or member, as the case may be, shall disclose the nature of his concern or interest at the meeting of the Board in which the contract or arrangement is discussed and shall not participate in such meeting:

## Disclosure of Interest – Section 184

- ✓ 2. Where any director who is not so concerned or interested at the time of entering into such contract or arrangement, he shall, if he becomes concerned or interested after the contract or arrangement is entered into, disclose his concern or interest forthwith when he becomes concerned or interested or at the first meeting of the Board held after he becomes so concerned or interested.

# Disclosure of Interest – Section 184

## Disclosure of nature of concern and interest

- ✓ 1. The nature of the interest must also be disclosed and not the fact of interest.
- ✓ 2. This normally involves disclosing the exact extent of the profit made by the interested director.
- ✓ 3. Disclosure under see 184(2) in which BM
- ✓ 4. Under section 184(2) in respect of a proposed contract to be entered coming up to board meeting level and where he is already a director and where the directors are already interested, the disclosure shall be made at that Board meeting at which contract was first taken into consideration.

# Disclosure of Interest – Section 184

## Disclosure under sec 184(2) in which BM

- ✓ 1. Under section 184(2) in respect of a proposed contract to be entered coming up to board meeting level and where he is already a director and where the directors are already interested, the disclosure shall be made at that Board meeting at which contract was first taken into consideration.
- ✓ 2. In respect of all other contracts, disclose his concern or interest forthwith when he becomes concerned or interested or at the first meeting of the Board held after he becomes so concerned or interested.

# Disclosure of Interest – Section 184

## Saving Clause

- ✓ Nothing in this section shall be taken to prejudice the operation of any rule of law restricting a director of a company from having any concern or interest in any contract or arrangement with the company;
- ✓ 1. It implies that this section will not override any other section.
- ✓ 2. If some other section restricts a director from having any concern or interest in any contract or arrangement, that section stands.

# Disclosure of Interest – Section 184

## Non applicability of section - 184(5)(b)

- ✓ 2. Nothing in this section shall apply to any contract or arrangement entered into or to be entered into between two companies or body corporate where any of the directors of the one company/body corporate or two or more of them together holds or hold not more than 2% of the paid-up share capital in the other company.
- ✓ 3. The purpose of the subsection, is to ignore small shareholding interests in the other company.
- ✓ 4. Since the expression used is 'not more than 2%', holding 'exactly 2% of the paid up share capital' does not require disclosure.
- ✓ 5. The directors should disclose his interest, even if his holding is less than 2% of the paid-up capital in case of corporation or foreign company.
- ✓ 6. Shareholding by any of the directors of the one company or two or more of them together shall be considered.

## Disclosure of Interest – Section 184

- ✓ 7. Regarding difficulty in ascertaining the other directors shareholding in the second company the department is of the view that it should not be difficult for the concerned directors to ascertain the shareholdings in the other company.
- ✓ 8. If the director is otherwise interested other than shareholding interest, his holding of less than 2% of the paid-up capital of the company is not relevant.
- ✓ 9. The date on which the contract is entered into is the point of time for ascertaining whether or not such holdings exceed the 2% limit.
- ✓ 10. Even where shares are held by a director non-beneficially, say on behalf of a trust, disclosure of interest would be necessary, since the trustee is the owner of the share. - Dept's Clarification
- ✓ 11. Where shares held by a director are transferred by him, but he continues to be the registered holder, for the transfer has not been registered, still he should disclose his interest in the shares - Dept's Clarification

# Disclosure of Interest – Section 184

## Applicability of section 184 to various directorships

- ✓ 1. It applies to directors nominated by the Govt and, thus, to other nominee directors. - Dept's Clarification.
- ✓ 2. An alternate director as well as original director should also send the disclosure in writing.
- ✓ 3. Disclosure of interest in general meetings
- ✓ 4. Sections 184 is limited to Board meetings only and they do not apply when a resolution is put before the general meeting.
- ✓ **5. Can a director exercise his voting right at a GM provided the interest has been disclosed in the explanatory statement?**

## ***Exemption***

***Section 184 (2) shall apply to a Section 8 company only if the transaction with reference to section 188 on the basis of terms and conditions of the contract or arrangement exceeds one lakh rupees; vide Notification F. No. 1 /2/2014-CL.I dated 5th June 2015.***

***Section 184(2) shall apply to a private company; with the exception that the interested director may participate in such meeting after disclosure of his interest; vide Notification F No 1/1/2014- CL.V dated 5th June 2015.***

# Disclosure of Interest – Section 184

## Absence of disinterested quorum

- ✓ 1. In the BM, if the quorum is not available, the Board's strength may be increased by appointing new disinterested directors.
- ✓ 2. If this is not found practicable, the matter shall be placed before the general meeting for the consent.
- ✓ 3. Comment: However, the latter course suggested by the DCA does not find support under the Act.

## Appointment of relative of director as director

- ✓ 1. Whether appointment of a relative of a director as a director attracts sections 184, the DCA views that 'Whatever may be the strict legal position, the matter is to be viewed from the point of view of the development of sound and healthy company practice'.
- ✓ 2. Hence appointment of a relative of a director as a director, will attract section 184.

## Disclosure of Interest – Section 184

### Exemptions -

- ✓ Section 184 (2) shall apply to a Section 8 company only if the transaction with reference to section 188 on the basis of terms and conditions of the contract or arrangement exceeds one lakh rupees; vide Notification F. No. 1 /2/2014-CL.I dated 5th June 2015.
- ✓ Section 184(2) shall apply to a private company; with the exception that the interested director may participate in such meeting after disclosure of his interest; vide Notification F No 1/ 1/2014- CL.V dated 5th June 2015

# Disclosure of Interest – Section 184

## Allotment of shares- will it attract sec 184

- ✓ 1. The word 'interest' should be 'interest conflicting with duty'.
- ✓ 2. Therefore if the board allot shares to themselves along with other shareholders there is no conflict of interest and Sec 184 does not apply.
- ✓ 3. But the allotment of shares to themselves further their personal interest as different from general interest of share holders, sec 184 will apply.

## Transfer of shares to director - sec 184?

- ✓ 1. In registration of transfer of shares to any director, the Board performs its statutory function.
- ✓ 2. In such registration no element of contract or arrangement is involved casting a duty of the transferee-director to disclose interest.

# Disclosure of Interest – Section 184

## Register of contracts in which directors are interested - sec 189

- ✓ 1. Every company shall maintain one or more registers in Form No. **MBP 4**, and shall enter therein:
  - company or companies or bodies corporate, firms or other association of individuals, in which any director has any concern or interest, as mentioned under section 184(1) and such holding is more than 2%.
  - contracts or arrangements with a body corporate or firm or other entity as mentioned under section 184(2), in which any director is, directly or indirectly, concerned or interested; and
  - contracts or arrangements with a related party with respect to transactions to which section 188 applies;

## Disclosure of Interest – Section 184

- ✓ 2. Entries in the register shall be made in chronological order and shall be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose.
- ✓ 3. Such register shall be kept at the registered office of the company. The register shall be preserved permanently and shall be kept in the custody of the secretary of the company or any other person authorized by the Board for the purpose.
- ✓ 4. Every director or KMP shall, within 30 days of his appointment, or relinquishment of his office, disclose the particulars specified in section 184(1) relating to his concern or interest in the other associations.
- ✓ 5. The register shall be kept at the registered office and it shall be open for inspection during business hours

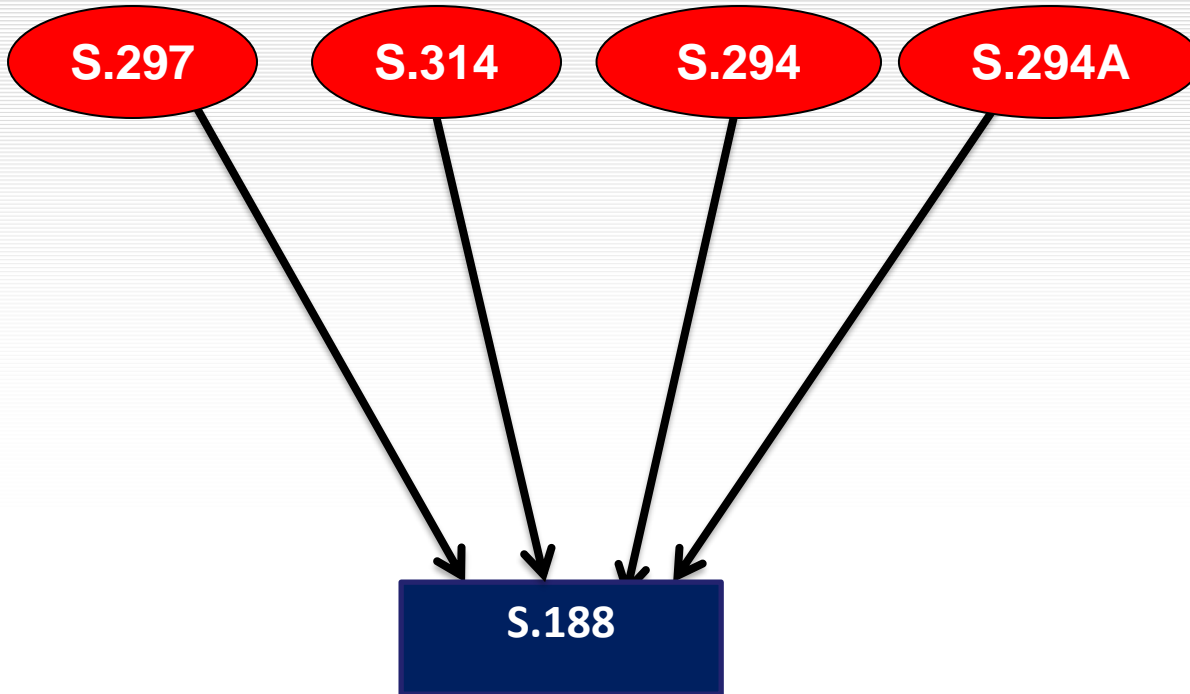
## Disclosure of Interest – Section 184

- ✓ 6. Extracts of the register shall be provided to the members within 7 days of request, on a fee of Rs. 10/- per page.
- ✓ 7. The register shall also be produced at the commencement of every AGM and shall remain accessible during the continuance of the meeting to any person having the right to attend the meeting.
- ✓ 8. Nothing contained in this section shall apply to any contract or arrangement for the sale, purchase or supply of Any goods. materials or services if the value of such goods and materials or the cost of such services does not exceed Rs. 5,00,000/- in the aggregate in any year; by a banking company for the collection of bills in the ordinary course of its business.
- ✓ 9. Every director who fails to comply with the provisions of this section and the rules made there-under shall be liable to a penalty of Rs. 25,000.



# RELATED PARTY TRANSACTIONS SEC 188

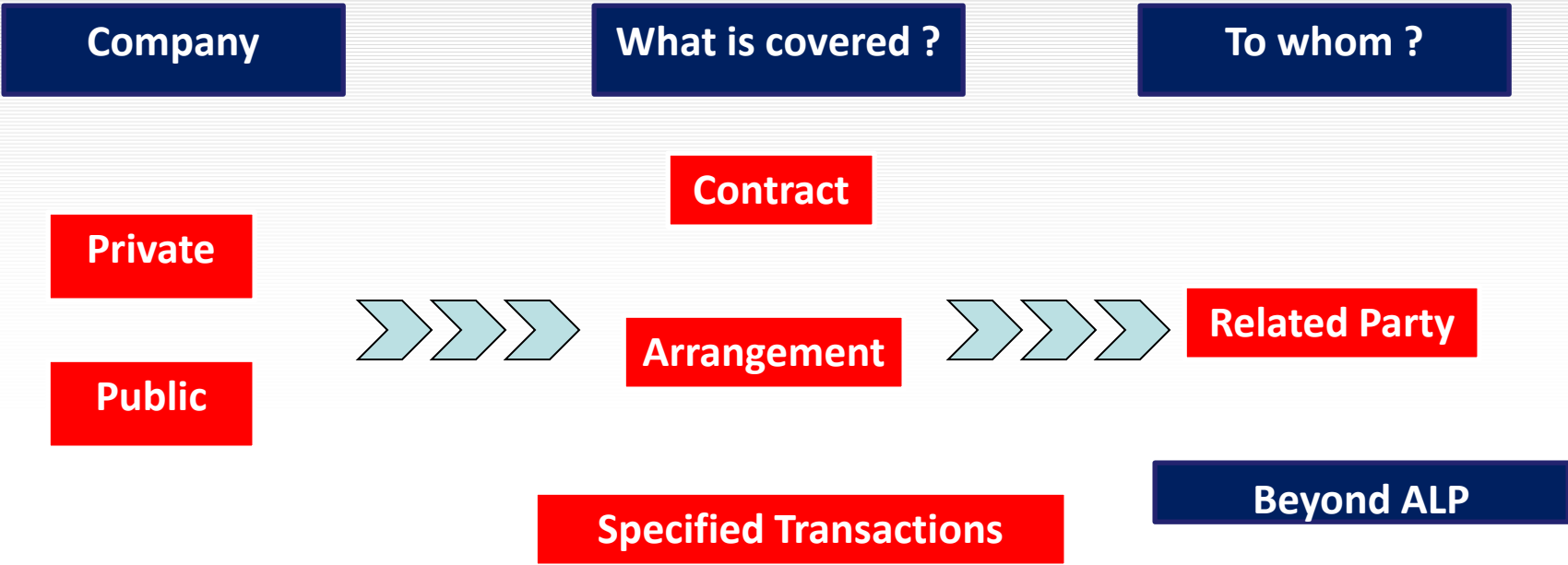
# Section 188 – A history



## Related Party Transactions – Sec188

✓ Except with the consent of the Board of Directors given by a resolution at a Board Meeting and subject to such conditions as may be prescribed, no company shall enter into any contract or arrangement with **a related party** with respect to **specified transactions**

# Section 188 break-up



# Related Party Transactions – Sec188

## Related Party” – 2(76)

- a director or his relative;
- a key managerial personnel or his relative;

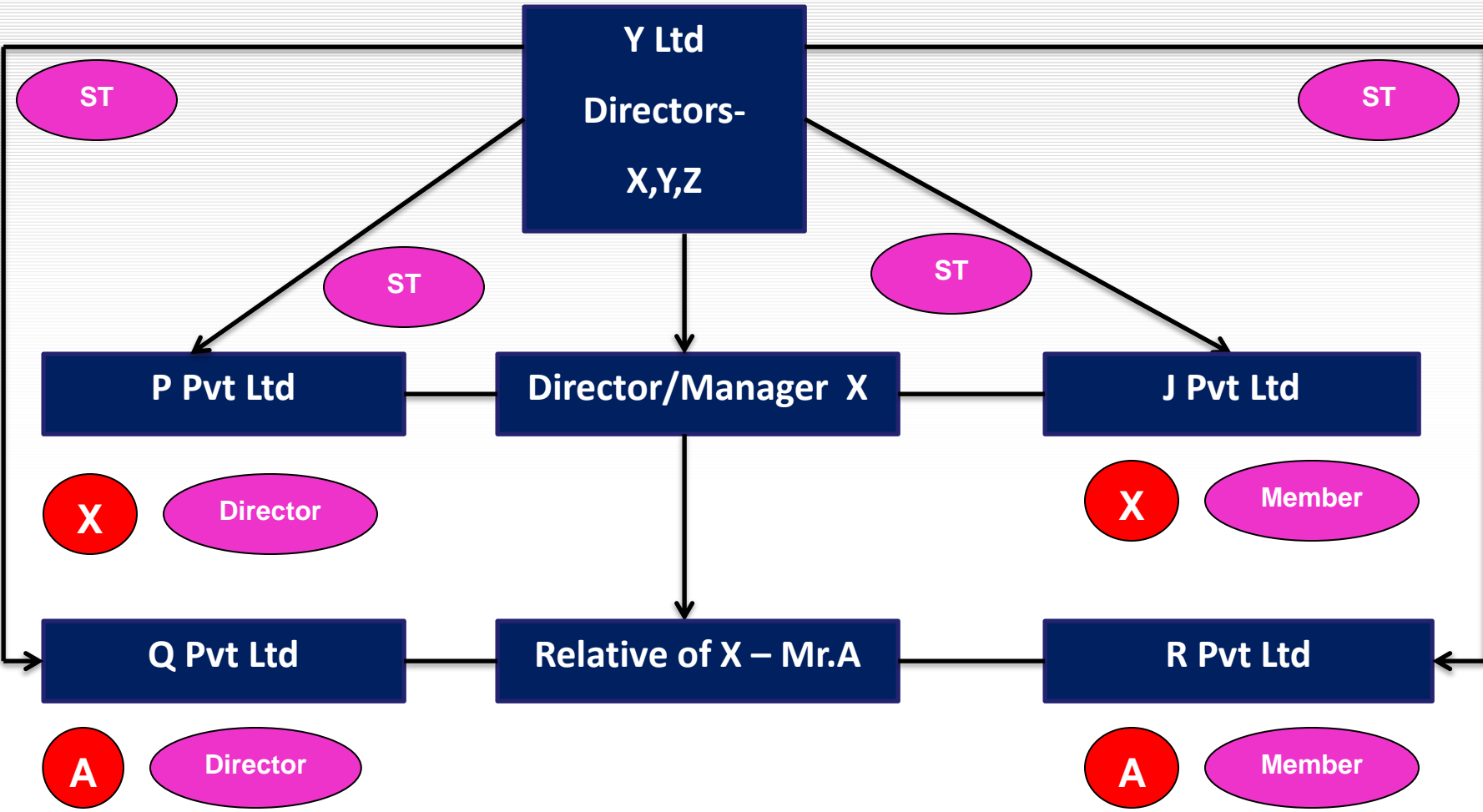
“key managerial personnel” means-

1. CEO or the MD ,or the Manager;
2. Company secretary;
3. Whole-time director;
4. Chief Financial Officer; and
5. such other officer as may be prescribed

## Related Party Transactions – Sec188

- a firm, in which a director, manager or his relative is a partner;
- a private company in which a director or manager **or his relative** is a member or director; **[ROD order]**
- a public company in which a director or manager is a director **AND** holds along with his relatives, more than 2% of its paid-up share capital; **[ROD order]**
- any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice directions or instructions of a director or manager

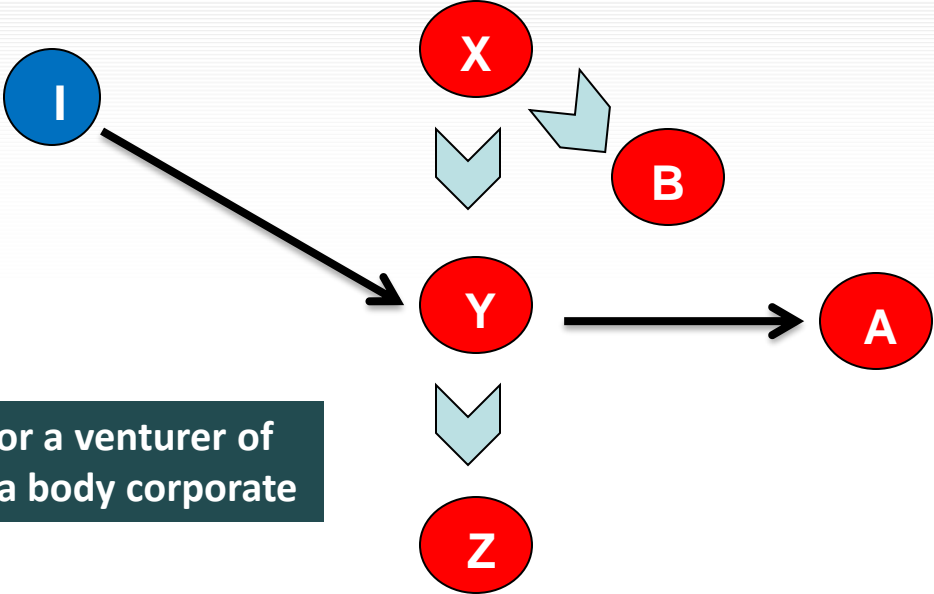
any Private company in which such dir/mgr of relative is a dir or member



## Related Party Transactions – Sec188

- any person on whose advice, directions or instructions a director or manager is accustomed to act
- Provided that nothing shall apply in the above 2 cases to the advice, directions or instructions given in a professional capacity;
- any company which is-
  - a holding, subsidiary or an **associate** company of such company; or
  - a subsidiary of a holding company to which it is also a subsidiary;
- such other person as may be prescribed;

### Section 2(76)- Definition of 'Related Party'



Investing company or a venturer of the company – “I” is a body corporate

# Related Party Transactions – Sec188

## Associate Company

1. “associate company”, in relation to another company, means a company in which
  - that other company has a **significant influence**,
  - but which is not a subsidiary company of the company having such influence and
  - includes a joint venture company.
2. Explanation - For the purposes of this clause,  
“significant influence” means control of at least 20% of total share capital, or of business decisions under an agreement;

## Related Party Transactions – Sec 188

### What are the transactions covered in Sec 188?

- ✓ sale, purchase or supply of any goods or materials;
- ✓ selling or otherwise disposing of, or buying, property of any kind;
- ✓ leasing of property of any kind;
- ✓ availing or rendering of any services;
- ✓ appointment of any agent for purchase or sale of goods, materials, services or property;

## Related Party Transactions – Sec 188

### What are the transactions covered in Sec 188?

- ✓ - such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and
- ✓ - underwriting the subscription of any securities or derivatives thereof, of the company:

## Related Party Transactions – Sec 188

### Sale, purchase or supply of any goods or materials either directly or through agents

- ✓ The word 'goods or materials' covered in this section includes capital goods.
- ✓ All cases Board approval at Board Meeting.
- ✓ **Prior Ordinary Resolution** for Transaction value exceeding 10% the turnover of the company or ~~100 crore,~~  
~~**whichever is lower**~~  
[shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year]

# Related Party Transactions – Sec 188

## Selling or disposing of, or buying property of any kind either directly or through agents

- ✓ The word 'goods or materials' covered in this section includes selling or disposing of, or buying property of any kind either directly or through agents
- ✓ Property includes immovable property.
- ✓ It could also cover intellectual property rights - patents, trademarks, copyrights, software, brands etc.
- ✓ All cases Board approval at Board Meeting.
- ✓ Prior Ordinary Resolution for,  
Transaction value exceeding  
10% the Net-worth of the company or  
~~100 crore,~~  
~~whichever is lower~~
- ✓ [shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year]

# Related Party Transactions – Sec 188

## Leasing of property of any kind

- ✓ Leasing could include franchise
- ✓ All cases Board approval at Board Meeting.
- ✓ Prior Ordinary Resolution for transaction value exceeding
  - 10% of Net worth of the company or
  - 10% of turnover of the company or
  - ~~-100 Crore,~~

### **whichever is lower**

[shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year]

## Related Party Transactions – Sec 188

### Availing or rendering of any services either directly or through agents

- ✓ Services could mean business and commercial services.
- ✓ Professional services were exempted in section 297 of Companies Act, 1956 through MCA clarification.
- ✓ All cases Board approval at Board Meeting.
- ✓ Prior Ordinary Resolution for Transaction value exceeding 10% of turnover of the company or ~~50 crore~~  
~~whichever is lower~~ [shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year]

## Related Party Transactions – Sec 188

### **Underwriting the subscription of any securities or derivatives thereof, of the company**

- ✓ - All cases Board approval at Board Meeting.
- ✓ - Prior Ordinary Resolution required if the remuneration exceeds 1 % of Networth of the Previous Financial Year.

## Related Party Transactions – Sec 188

**such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company**

“office or place of profit” means any office or place-

- ✓ - where such office or place is held by a director, if the director holding it receives from the company anything by way of remuneration **over and above the remuneration** to which he is entitled as director, by way of salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;
- ✓ - where such office or place is held by an individual other than a director or by any firm, private company or other body corporate, if the individual, firm, private company or body corporate holding it receives from the company **anything by way of remuneration**, salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;

## Related Party Transactions – Sec 188

- ✓ All cases Board approval at Board Meeting.
- ✓ Prior Ordinary resolution required if the monthly remuneration exceed Rs 2,50,000.
- ✓ In the Ravinder Kumar Singhal case, it was held that, perquisites accruing on monthly basis should be included and not total yearly earning. So annual payments like bonus, leave encashment, reimbursement of medical expenses are not to be included.

# Related Party Transactions – Sec 188

## ✓ Exemptions under sec 188

- ✓ 1. This section will not apply to any transactions entered into by the company in its ordinary course of business and transactions which are on arm's length basis.
- ✓ 2. “Arm's length transaction” means a transaction between two related parties that is conducted as if they were unrelated, **so that there is no conflict of interest.**
- ✓ 3. S.92F Income Tax Act - "arm's length price" means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions

# Related Party Transactions – Sec 188

Ordinary course of business ?

## ICAI Guidance Note

Standard on Auditing (SA) 550 Related Parties (Paragraph A25) has listed certain examples of transactions outside the entity's normal course of business:

- (i) **Complex equity transactions**, such as corporate restructurings or acquisitions
- (ii) **Transactions with offshore entities** in jurisdictions with weak corporate laws
- (iii) The leasing of premises or **the rendering of management services** by the entity to another party **if no consideration is exchanged**
- (iv) Sales transactions with **unusually large discounts** or returns
- (v) Transactions with circular arrangements, for example, **sales with a commitment to repurchase**

# Related Party Transactions – Sec 188

## Ordinary course of business ?

Indicators based on which one may consider following aspects while performing evaluation of ‘ordinary course of business’:

- (ii) Whether the transaction is covered in the objects of the company as envisaged in the **Memorandum of Association**;
- (ii) Whether a transaction is usual or unusual, both from the company and its line of business perspective;
- (iii) Frequency: If a transaction is happening **quite frequently** over a period of time, it is more likely to be treated as an ordinary course of business. However, the inverse does not necessarily hold true;
- (iv) Whether transaction is taking place at arm’s length;
- (v) Business purpose of the transaction;
- (vi) Whether transaction is done on **similar basis with other third parties**; and
- (vii) Size and volume of transaction.

# Related Party Transactions – Sec 188

## ✓ Exemptions under sec 188

✓ First and second proviso shall not apply to --

(a) a Government company in respect of contracts or arrangements entered into by it with any other Government company;

**[ Example – BHEL with Bank of India]**

(b) a Government company, other than a listed company, in respect of contracts or arrangements other than those referred to in clause (a), in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before entering into such contract or arrangement.

**[Example – Airports Authority of India and Cement Corporation of India]**

vide Notification F No 1/2/2014-CL.V dated 5th June 2015.

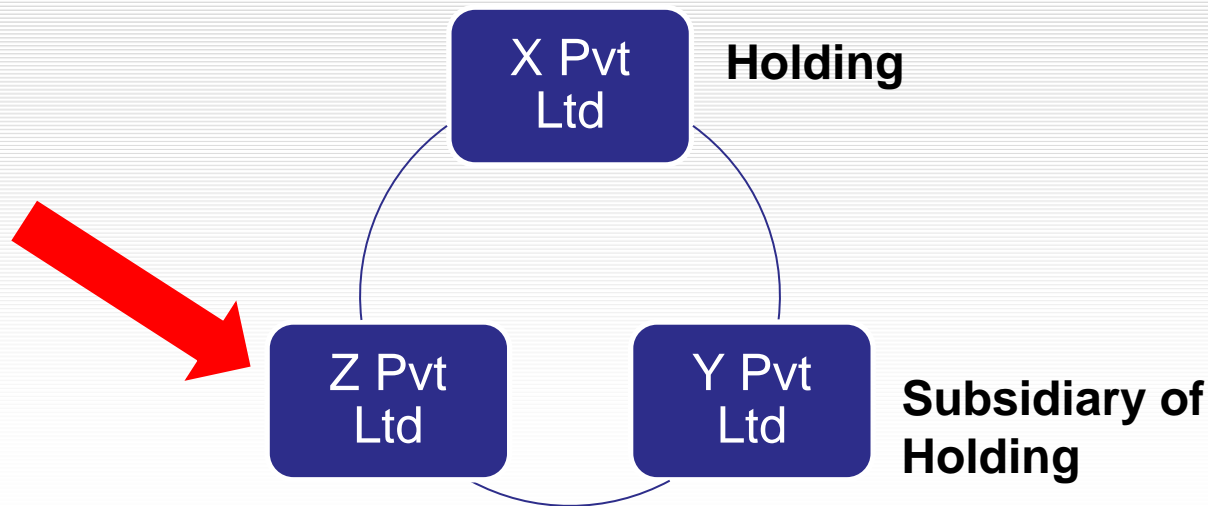
# Related Party Transactions – Sec 188

## Other Issues in section 188

1. The section covers
  - ✓ - oral and written contracts.
  - ✓ - contract for present sale of goods
  - ✓ - contract to sell goods at a future time.
2. The section does not contemplate a general consent of the board but a consent referable to each particular or specific contract.
3. Section 188 applies to public as well as **private companies**.

# Compliance Action Point

## Related Party Issues in Private Companies



Now if either X Pvt Ltd or Y Pvt Ltd is appointed in Z Pvt Ltd – OOP/SSA, then will S.188 apply ?

✓ **2(76)(viii)** → A company which is a holding company (**X Pvt Ltd**), subsidiary or a subsidiary of holding (**Y Pvt Ltd**) is a Related Party

✓ **188(1)(f)** → related party's appointment to OOP in the company

# Compliance Action Point

## Related Party Issues in Private Companies

Section	Notification as on 05/06/2015
2(76)(viii)	Shall not apply with respect to section 188.
188	188 is applicable to Private Companies. Only 2 <sup>nd</sup> proviso to 188(1) N.A
Ans	No Resolution required since holding and sub of holding not a related party w.r.t 188

# Compliance Action Point

## Interested Director + Related Party

Section	Details	Notification as on 05/06/2015
184	Interested director of ALL companies cannot vote on a proposed contract	Interested director may <u>participate</u> in such meeting after disclosure of his interest
188 2 <sup>nd</sup> proviso	No member can vote in a Special Resolution if he is a related party to the proposed contract	Only 2 <sup>nd</sup> proviso to 188(1) N.A

# Related Party Transactions – Sec 188

## COMPANIES AMENDMENT ACT 2017

Nothing contained in the second proviso shall apply to a company in **which ninety percent or more members**, in number, are relatives of promoters or are related parties

**Fundamental difference between 177 and 188**

**In 177 – all transactions – whether ordinary business or not – whether arms length or not require approval.**

Topic

Companies (Amendment) Bill 2017

Audit Committee New provisions

1

- Related Party Transactions to be approved by Audit committee or Board of Directors

2

- If Director enters into a transaction with company for less than a crore and doesn't take approval from the committee within 3 months, transaction is Voidable + Director has to indemnify.
- More than 1 crore – Prior approval of Audit Committee

# Related Party Transactions – Sec 188

## 188 vs LODR

- ✓ **Related party definition – linked to 2(76) for seeking authorisation and IND-AS 24 for accounting**
- ✓ **Related party transaction – wide amplitude – “transfer of resources, services or obligations regardless of whether a price is charged”**
- ✓ **Material RPT – Transactions > 10% annual consolidated turnover**
- ✓ **w.e.f April 1 2019 – Payments to RP for brand usage or royalty – material – if value > 2% of consolidated turnover**
- ✓ **All RPs can either abstain or vote negatively**



# Audit Procedures and Reporting – S.188 and S.184

# Related Party Transactions – Sec 188

## Procedure under Sec 188

- ✓ 1. The consent of the board shall be required for all specified transactions with “related party.”
- ✓ 2. Such consent shall be accorded only by passing a resolution at the Board meeting and not by circulation.
- ✓ 3. The **notice** of the Board meeting at which the resolution is proposed to be moved shall disclose-
  - ✓ - name of the related party and nature of relationship;
  - ✓ - nature, duration of the contract and particulars of the contract or arrangement;
  - ✓ - material terms of the contract or arrangement including the value, if any;  
- any advance paid or received for the contract or arrangement, if any; and
  - ✓ - Manner of determining the pricing and commercial terms, both included as part of contract and not considered as part of contract.
  - ✓ - Whether all factors relevant to the contract have been considered, if not, details of factors not considered with the rationale of not considering those factors.
  - ✓ - any other information relevant or important for the Board to take a decision on the proposed transaction.

## Related Party Transactions – Sec 188

- ✓ 4. Where any director is interested in any contract or arrangement with a related party, such director shall not be present at the meeting during discussions on the subject matter of the resolution relating to such contract or arrangement.
  
- ✓ 5. The explanatory statement to the notice of a general meeting shall contain the following particulars:
  - name of the related party;
  - name of the director/KMP who is related;
  - nature of relationship;
  - nature, material terms, monetary value and particulars of the contract or arrangement;
  - any other information relevant/important for the members to take a decision

## Related Party Transactions – Sec 188

- ✓ 7. In case of wholly owned subsidiary, **the special resolution passed by the holding company shall be sufficient for the purpose** of entering into the transactions between wholly owned subsidiary and holding company.
- ✓ 8. Every contract or arrangement entered into under subsection (1) shall be referred to in the Board's report to the shareholders along with the justification for entering into such contract or arrangement.
- ✓ 9. The interested director in the related party transaction under section 188 shall disclose his interest in the Board Meeting as specified in section 184 and shall also not participate in such meeting as specified in section 184.

# Disclosure of Interest – Section 184

## Register of contracts in which directors are interested - sec 189

- ✓ 1. Every company shall maintain one or more registers in Form No. **MBP 4**, and shall enter therein:
  - company or companies or bodies corporate, firms or other association of individuals, in which any director has any concern or interest, as mentioned under section 184(1) and such holding is more than 2%.
  - contracts or arrangements with a body corporate or firm or other entity as mentioned under section 184(2), in which any director is, directly or indirectly, concerned or interested; and
  - contracts or arrangements with a related party with respect to transactions to which section 188 applies;

# Disclosure of Interest and RPT

## FORM MBP.4

Register of contracts with related party and contracts and Bodies etc. in which directors are interested

*[Pursuant to section 189(1) and rule 16(1)]*

A. Contracts or agreements with any related party under section 188 or in which any director is concerned or interested under sub-section (2) of section 184

Date of contract/ arrangement	Name of the party with which contract is entered into	Name of the interested director	Relation with director/ company/ Nature of concern or interest	Principal terms and conditions	Whether the transaction is at arm's length basis
(1)	(2)	(3)	(4)	(5)	(6)

Date of approval at the meeting of the Board	Details of voting on such resolution				Date of the next meeting at which register was placed for signature
	No. of Directors present in the meeting	Directors voting in favour	Directors voting against	Directors remaining neutral	
(7)	(8)	(9)	(10)	(i)	(12)

# Disclosure of Interest and RPT

Reference of specific items - (a) to (g) under sub-section (1) of section 188	Amount of contract or arrangement	Date of share holders approval if any	Signature	Remarks, if any	
(13)	(14)	(15)	(16)	(17)	

B. Name of the bodies corporate, firms or other association of individuals as mentioned under sub-section (1) of section 184, in which any director is having any concern or interest

Names of the Companies/bodies corporate/firms/ association of individuals	Name of the interested director or	Nature of interest or concern/ Change in interest or concern	Shareholding (if any)	Date on which interest or concern arose/changed

Signature:

MD / Director / Secretary / Whole time Director

Place:

Date:

# RPT – AOC-4 Pursuant to S.137

## Segment IV: DISCLOSURE ABOUT RELATED PARTY TRANSACTIONS

Disclosure of particulars of contracts/arrangements entered into by the company with related parties referred to in sub-section (1) of section 188 of the Companies Act, 2013 including certain arm's length transactions under third proviso thereto

1. Number of contracts or arrangements or transactions not at arm's length basis

Name(s) of the related party	Nature of relationship	Nature of contracts/ arrangements/ transactions

Duration of the contracts / arrangements/ transactions	Date of approval by the Board	Amount paid as advances, if any	Date on which the special resolution was passed in general meeting as required under first proviso to section 188

2. Number of material contracts or arrangement or transactions at arm's length basis

Name(s) of the related party	Nature of relationship	Nature of contracts/ arrangements/ transactions

Duration of the contracts / arrangements/ transactions	Date of approval by the Board	Amount paid as advances, if any

# CARO 2016 Reporting – S.188 and S.184

## Clause 3

Whether the company has granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under section 189 of the Companies Act, 2013. If so,

- ✓ (a) whether the **terms and conditions** of the grant of such loans are **not prejudicial** to the company's interest;
- ✓ (b) whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are **regular**;
- ✓ (c) if the amount is overdue, state the total amount **overdue for more than ninety days**, and whether **reasonable steps** have been taken by the company for recovery of the principal and interest;

## CARO 2016 Guidance Note – 23-04-2016

- i. Loans granted + Loans renewed during the year
- ii. Auditor is required to disclose the requisite information in his report in respect of all 189 parties ***irrespective of the period to which such loan relates***
- iii. All kind of loans whether long term or short term, whether given in cash or in kind
- iv. Get acquainted with S.184 + 188+ 189
- v. The auditor may also consider verifying returns filed or certificates obtained by the management in this regard.
- vi. Not just outstanding loans, but also loans **squared up during the year** to be considered

## CARO 2016 Guidance Note – 23-04-2016

(a) whether the **terms and conditions** of the grant of such loans are **not prejudicial** to the company's interest;

i. Covers the loans **granted during the year** and also all loans having opening balances.

ii. Check loan agreements

iii. The “terms and conditions” would primarily include

- rate of interest,
- security,
- period of repayment
- restrictive covenants, if any.

## CARO 2016 Guidance Note – 23-04-2016

iv. Due consideration to the other factors connected with the loan, including its

- ✓ ability to lend,
- ✓ terms of its borrowings,
- ✓ borrower's financial standing,
- ✓ Credit rating, if available,
- ✓ the nature of the security,
- ✓ rate of interest

v. For the purpose of reporting under this clause ***the auditor may consider clause (7) of Section 186 of the Act*** wherein it is specified that no loan, covered under this section, shall be given at a rate of interest lower than the prevailing yield of one year, 3 year, five year or ten year government security close to the tenor of the loan, to the extent applicable

## CARO 2016 Guidance Note – 23-04-2016

- vi. Audit enquiry ***u/s 143(1) (a) also applicable***
- vii. Further, the auditor may also come across a situation where the company has a ***policy of providing loans at concessional rates of interest to its employees*** and such a loan has been given to a relative of the director who is also an employee of the company.

In such a case also, the auditor would be required to examine and comment whether loan is prejudicial to the interests of the company. It may, however, be noted that normally such terms as per the policy followed by the company ***cannot be said to be prejudicial to the interest of the company if other employees of the company also receive the loan on the same terms***

## CARO 2016 Guidance Note – 23-04-2016

viii.

The following is an example of an unfavourable comment by the auditor under this clause:

“According to the information and explanations given to us and based on the audit procedures conducted by us, we are of the opinion that the terms and conditions of loans granted by the company to two parties covered in the register maintained under section 189 of the Companies Act, 2013, (total loan amount granted Rs ---- and balance outstanding as at balance sheet date Rs -----) are prejudicial to the company’s interest on account of the fact that the loans have been granted at an interest rate of X% per annum which is significantly lower than the cost of funds to the company and also lower than the prevailing yield of government security close to the tenor of the loan”

## CARO 2016 Guidance Note – 23-04-2016

(b) whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are **regular;**

- i. Check agreement for schedule of repayment including interest. If no agreement, report accordingly
- ii. “Regular” – received whenever due
- iii. Non-stipulation of schedule of repayment of principal & payment of Interest - the auditor should state the fact and may report that he is unable to make specific comment on the regularity of repayment of principal & payment of interest, in such cases.

## CARO 2016 Guidance Note – 23-04-2016

(c) if the amount is overdue, state the total amount **overdue for more than ninety days**, and whether **reasonable steps** have been taken by the company for recovery of the principal and interest;

- i. Compare agreement with actual repayment made to arrive at 90 days
- ii. It is not necessary that steps to be taken must necessarily be legal steps.
- iii. Depending upon the circumstances, **issue of reminders or the sending of an advocate's or solicitor's notice, may amount to "reasonable steps" even though no legal action is taken.**

## CARO 2016 Guidance Note – 23-04-2016

(c) if the amount is overdue, state the total amount **overdue for more than ninety days**, and whether **reasonable steps** have been taken by the company for recovery of the principal and interest;

iv. Reporting of such cases may be made incorporating following details:

- ✓ No. of Cases
- ✓ Principal Amount Overdue
- ✓ Interest Overdue
- ✓ Total Overdue
- ✓ Remarks, if any (specify whether reasonable steps have been taken by the Company for recovery of principal amount and interest)

# CARO 2016 Reporting – S.188 and S.184

## Clause 13

Whether all transactions with the related parties are in compliance **with sections 177 and 188** of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards;

## CARO 2016 Guidance Note – 23-04-2016

i. The auditor should obtain **written representations** from management and, where appropriate, those charged with governance that:

- ✓ (i) They have **disclosed to the auditor the identity** of the entity's related parties and all the related party relationships and transactions of which they are aware; and
- ✓ (ii) They have **appropriately accounted for and disclosed** such relationships and transactions in accordance with the requirements of the framework

## CARO 2016 Guidance Note – 23-04-2016

- ii. MBP 1 + Completeness of Mgt Information
- iii. Review his *previous years working papers* to identify 188 parties mentioned in 189 register
- iv. Review *entity's procedures* of identifying 188 parties
- v. Circumstances in which it may be appropriate to obtain written representations from those charged with governance include:
  - (i) When they have approved specific related party transactions that
    - ✓ a) materially affect the financial statements, or
    - ✓ b) involve management.
  - (ii) When they have made specific oral representations to the auditor on details of certain related party transactions

## CARO 2016 Guidance Note – 23-04-2016

vi. Follow SA 550

vii.

Based on the procedures performed by the auditor, if auditor comes across any non-compliance, then, it should be duly reported. The following particulars may be incorporated:

Nature of the related party relationship and the underlying transaction	Amount involved (Rs.)	Remarks ( <i>details of non-compliance may be given</i> )



# Discussion Item 2 Penal Provisions

# Comprehensive Penal Provision Chart

Particulars	S.185	S.186	S.184	S.188
Penalised	Company Director Other person	Company Every OID	Director	Director
Company	5L-25L	25K-5L	-	-
Director/OID	Upto 6M/ 5L-25L/ Both	25K-1L AND Upto 2 years	Upto 1 year/ 1L/ Both	a. Indemnify the company for loss b. Listed- Upto 1 year/25K-5L/Both c. Other- 25K-5L
Contract	Not affected	Not affected	Voidable at the option of SH	Voidable at the option of BOD/SH
Relaxation	No ppn redn	No ppn redn	No	No
Compounding	Yes	No	Yes	Yes
Disqualification	No	No	No	164(1)(g) Last 5 years
Vacation of Office	No	No	167(1)(c) and (d)	167(1)(a)



**THANK YOU FOR YOUR PATIENCE**

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- Punarvas cleared the much sought after Chartered Accountancy course in 2012 in his first attempt
- **He has worked on several large corporate clients like Infosys, MetLife, ING etc and has also handled litigation at various appellate levels for a large number of clients**
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