



## *Compliance with Companies Act, 2013 in relation to Key Managerial Personnel Part-XI*

*In our previous update in relation to Key Managerial Personnel (KMP), we had outlined the manner of appointment of KMP, procedure for appointment with a focus on corporate governance and the like. This update seeks to outline the key provisions of the Companies Act, 2013 (the “Act” or the “new Companies Act”) that elevate the status of KMP conferring upon them the sanctity conferred upon the office of a director under the old as well as the new Companies Act.*

*The Companies Act, 1956 (the “1956 Act”) did not define the term Key Managerial Personnel (KMP). Managerial personnel under the 1956 Act however included the Managing Director, Manager and Secretary, whereas the new Companies Act, in addition to these has added Chief Executive Officer, Chief Financial Officer and Company Secretary to the ambit of KMP<sup>1</sup>. The important functionaries of a company apart from the Directors were largely referred to in reference to an officer in default of a company on whom penal liability is to be hoisted.*

### *Officer and Officer in Default*

The definition of “officer” under the new Companies Act as well as the 1956 Act covered the director, manager and secretary and generally any other office under who’s authority the Board was accustomed to act under the definition of officer. Given the wide definition of KMP under the new Companies Act, the term “officer” is given a much wider connotation under the Act.

The number of persons directly brought under the ambit of “officer in default” in the Act is much wider than the definition given in the 1956 Act. Unlike the 1956 Act, the new Companies Act specifically recognises CEO, CFO and Company secretary bringing them within the scope of officer in default as KMP.

### *Colourability of Appointments*

1. Appointment as Auditor - No person can now be appointed as the auditor of the company whose relative is director of such company or is in the employment of the company as a director or KMP.
2. Appointment as Independent Director - Any person who, either himself or any of his relatives holds or has held the position of a KMP or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial

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<sup>1</sup> Section 2(51) of the new Companies Act defines KMP as, “key managerial personnel” in relation to a company means –

- the Chief Executive Officer or the Managing Director or the Manager;
- the Company Secretary;
- the Whole-Time Director;
- the Chief Financial Officer; and
- such other officer as may be prescribed.



years immediately preceding the financial year in which he is proposed to be appointed cannot be appointed as Independent Director of the company.

### *Additional Disclosure Obligations*

- Board's Report - In terms of Rule 5 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, every listed company is mandated to file a disclosure as part of the Board's report which includes a comparison of each remuneration of the KMP against the performance of the company.
- Annual Returns to contain particulars of KMP - Annual Return of every company shall *inter alia* contain the particulars of KMP as they stood on the close of the financial year as compared to the particulars as they stood since the close of the previous financial year as well as remuneration of the KMP. The officer in default in respect of non-compliance with this provision shall be punishable with imprisonment for a term up to six months, or with fine between INR 50,000 (Rupees Fifty Thousand) to INR 5,00,000 (Rupees Five Lakh), or with both.
- Notice of Special business at a general meeting - As per Section 102(1) whenever special business is to be transacted at a general meeting, the statement annexed to the notice of the meeting shall contain material facts like the nature of concern or interest, financial or otherwise, if any, in respect of each items of:
  - a) every director and the manager, if any;
  - b) every other KMP, if any; and
  - c) relatives of the persons mentioned in a) and b)

The proviso to Sub-Section 2 of Section 102 also states that where any special business to be transacted at a meeting of the company relates to or affects any other company, the extent of shareholding interest in that other company of every promoter, director, manager, if any, and of every other KMP of the first mentioned company shall, if the extent of such shareholding is not less than two percent of the paid-up share capital of that company, also be set out in the statement. If as a result of non-disclosure or insufficient disclosure being made by a promoter, director, manager, if any, or other KMP, any benefit which accrues to them or their relatives, he shall hold such benefit in trust for the company, and shall, without prejudice to any other action being taken against him under the Act or under any other law for the time being in force, be liable to compensate the company to the extent of the benefit received by him. Default in compliance with this provision shall be punishable with the higher of fine up to INR 50,000 (Rupees Fifty Thousand) or five times the amount of benefit accrued.

- Disclosures by the KMP - A KMP shall within a period of 30 days of his appointment, or relinquishment of his office, as the case maybe disclose to the company his concerns or interest in any company or companies or bodies corporate, firms or other association of individuals which shall include the shareholding in such manner as may be prescribed. These details are to be recorded in the register of contracts or arrangements. Failure to comply shall attract a penalty of INR 25,000 (Rupees Twenty Five Thousand).



### *Inclusion in Related Party*

The definition of “related party” under Section 2(76) which is new under the Act includes a KMP or his relative. *For further information on related party transactions please see [here](#).*

### *Right to be heard in Audit Committee’s meeting*

KMP along with the auditors of the company shall have the right to be heard in the meeting of the Audit Committee when it considers the Auditor’s Report but shall not have the right to vote. Under the 1956 Act only the auditors, internal auditor (if any) and the director in-charge of finance could attend the meetings of the Audit Committee.

### *Dealings in securities*

1. Prohibition on Forward Dealings - KMPs shall not indulge in forward dealings in securities of company, or in its holding, subsidiary or associate company. Contravention of this provision shall be punishable with imprisonment for a term up to two years or with fine between INR 1,00,000 (Rupees One Lakh) to INR 5,00,000 (Rupees Five Lakh), or with both. In addition to the above penalty such KMP shall be liable to surrender the securities acquired by way of forward dealing to the company and the company shall not register the same in his name in the register if in physical form or through intimation to depository if in dematerialised form. Such securities shall continue to remain in the names of the transferors.
2. Prohibition on Insider Trading - Hitherto, insider trading has been dealt with under the SEBI Act, 1992 by the SEBI. There were no provisions in the 1956 Act dealing with insider trading. Section 195 of the Act prohibits any person including the director or KMP of the company from entering into insider trading. Punishment for insider trading shall be imprisonment for a term which may extend to five years, or with fine which shall not be less than INR 5,00,000 (Rupees Five Lakh) but which may extend to INR 2,50,000,000 (Rupees Twenty Five Crore) or three times the amount of profits made out of insider trading, whichever is higher, or with both.

### *In Conclusion*

A wide gap has been bridged by the new Companies Act, whereby promoters and their relatives could escape liabilities hoisted upon them in law by avoiding any of the named managerial positions. In this regard the various regulators seem to be in alignment. Recently, SEBI has penalised a company secretary of a listed corporation for passing on information without applying his/her mind to the disclosure citing non-compliance with the insider trading provisions.

Many of the KMP would on account of their proximity to the promoters or other persons in control be parties to wrong doings by the company. The spate of scams such as the Satyam scam have thrown light on this glaring gap in the law which is sought to be addressed by the new Companies Act. Having said that, often key managerial personnel are employees who are expected to do their job and align themselves to the controlling interest. The new Act would reign in both categories of KMP.