

CARO, 2003 & REGISTER UNDER SECTION 301

INTRODUCTION

The Companies (Auditor's Report) Order, 2003 has required an auditor to comment on matters relating to the Register maintained under Section 301 by Companies.

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There are 3 paragraphs in the Order that require an auditor to comment upon matters covered in the 301 Register. The most important addition to the CARO in respect of the 301 Register as against the earlier requirement in MAOCARO is the duty cast on the Auditor to comment as to whether the Company has entered all particulars that are required to be entered in it [Para 4(V)(a)]. The earlier requirement under MAOCARO in respect of 301 Register was to state as to whether the Company has any transaction with parties listed in the Register maintained under Section 301.

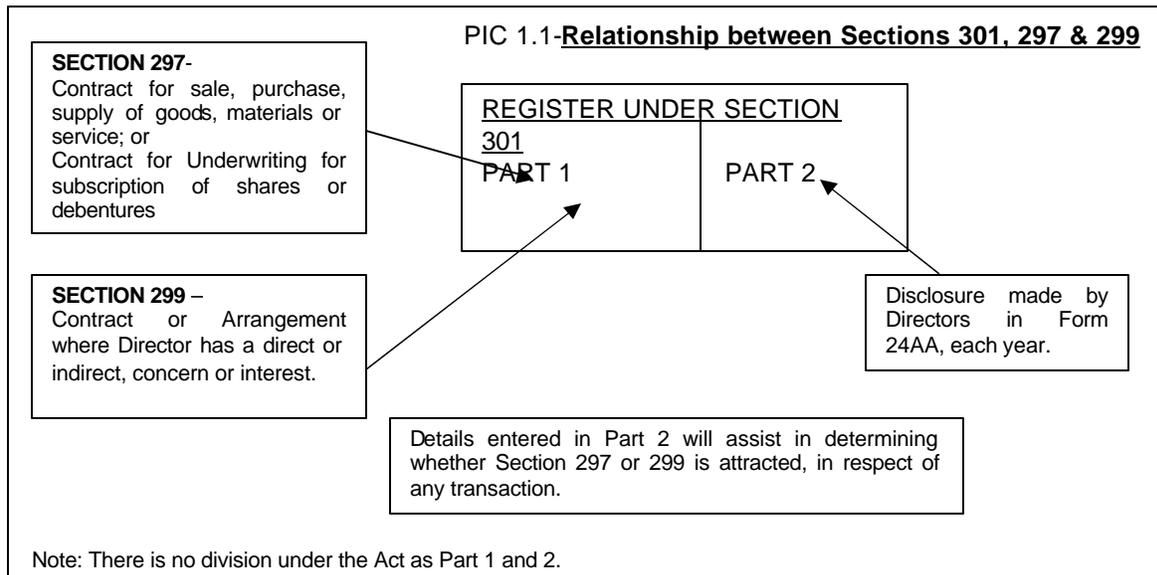
This requirement to comment on the entries in the 301 Register was first made mandatory in the Compliance Certificate to be given by Company Secretaries under the proviso to Section 383A of the Companies Act, 1956.

In this article the relationship between Sections 297, 299 and 301 is discussed, and also the additional information that is required to be obtained by the Auditor for commenting upon the completeness of the 301 Register is discussed.

MATTERS TO BE ENTERED IN THE 301 REGISTER

The matters to be entered in the Register can be divided into two, viz:

- (a) Contracts and arrangements-
 - i. to which Section 297 is applicable;
 - ii. to which Section 299 is applicable.
- (b) Disclosure made by a Director in Form 24AA, under Section 299(3).



PARTIES COVERED IN REGISTER MAINTAINED UNDER SECTION 301

Paras 4(iii)(a), 4(iii)(e) and 4(xvii) require the auditor to comment upon transactions of certain nature entered by the Company with “Parties covered in register maintained under Section 301”.

Under Section 299(3) of the Act, every Director is required to give a disclosure in Form 24AA to the Company before the end of each financial year, the following details:

- (a) Names of the bodies corporate wherein he is a Director;
- (b) Names of the bodies corporate wherein he has a shareholding;
- (c) Names of the firms wherein he is a Partner or is a Member.

Every Company as laid down in Section 301(3) of the Act, should enter the information given in Form 24AA each year, in the Register under Section 301, which in the above picture is categorised as Part 2.

For the purpose of commenting upon the aforesaid Paragraphs, it is these parties named therein who will be construed to be “Parties covered in the register maintained under Section 301”.

A. APPLICABILITY OF SECTION 297

Under this Section, a Contract of a specified nature can be entered into by a Company (whether Private or Public), with certain specified parties only after obtaining the approval of the Board of Directors. The nature of the contract and the specified parties are depicted in Pic 1.2. In respect of these contracts to be inked by a Company that has a paid-up capital of Rs. 1 Crore and above, the Company should obtain the prior approval of the Central Government. It is only after obtaining such prior approval can the

Company ink the deal and commence the transaction. The Section by implication excludes Contracts between two Public Companies. Pic 1.3 lists the contracts with certain parties that do attract the provisions of this Section.

Section 297 covers within it, only purchase, sale, supply of goods, materials and services. It does not cover matters relating to loan to/from the specified parties, or lease of immovable property to/from the specified parties and the like.

The approval of the Board of Directors under this Section should be obtained prior to entering into the Contract.

A.1 Contracts where Board's approval can be subsequent to the date of contract:

A Contract can be entered into between the Company and the specified persons (Pic 1.2), without obtaining the permission of the Directors, only if there exist a business circumstance which requires the sale or purchase be made to or from the persons listed above or service rendered / availed to / from the above listed persons, urgently. However, it is necessary that the Board's approval should be obtained for such a contract within 3 months from the date of entering into the same.

However, if the approval of the Board is sought after a period of 3 months from the date on which the Contract is entered into, the Board is at its liberty to make the contract void *ab initio* and direct accordingly.

Seeking the approval of the Board subsequent to entering into the Contract would not be applicable for a transaction that requires the prior approval of the Central Government, wherein the approval of the Board of Directors has to be first obtained for the draft contract to be entered into on its approval by the Central Government.

A.2 Board approval whether at a Meeting of the Board or by Circulation:

In respect of Contracts that fall within the purview of Section 297, the approval of the Board has to be obtained only at a Board Meeting and cannot be obtained by way of Circulation. If the approval for such a matter is obtained by way circulation, then it is to be construed that no approval has been obtained. Further, even if the Contract is entered into without obtaining the Board's approval it would still be required to be entered in the 301 Register, within 7 days from the date of entering into the Contract, as the relevant issue is whether the contract is one to which the provisions of Section 297 is applicable or not, and not whether the approval of the Board is obtained or not. In case the Board subsequently, decides to make the contract void, that fact would also have to be entered into in the Register of Contracts.

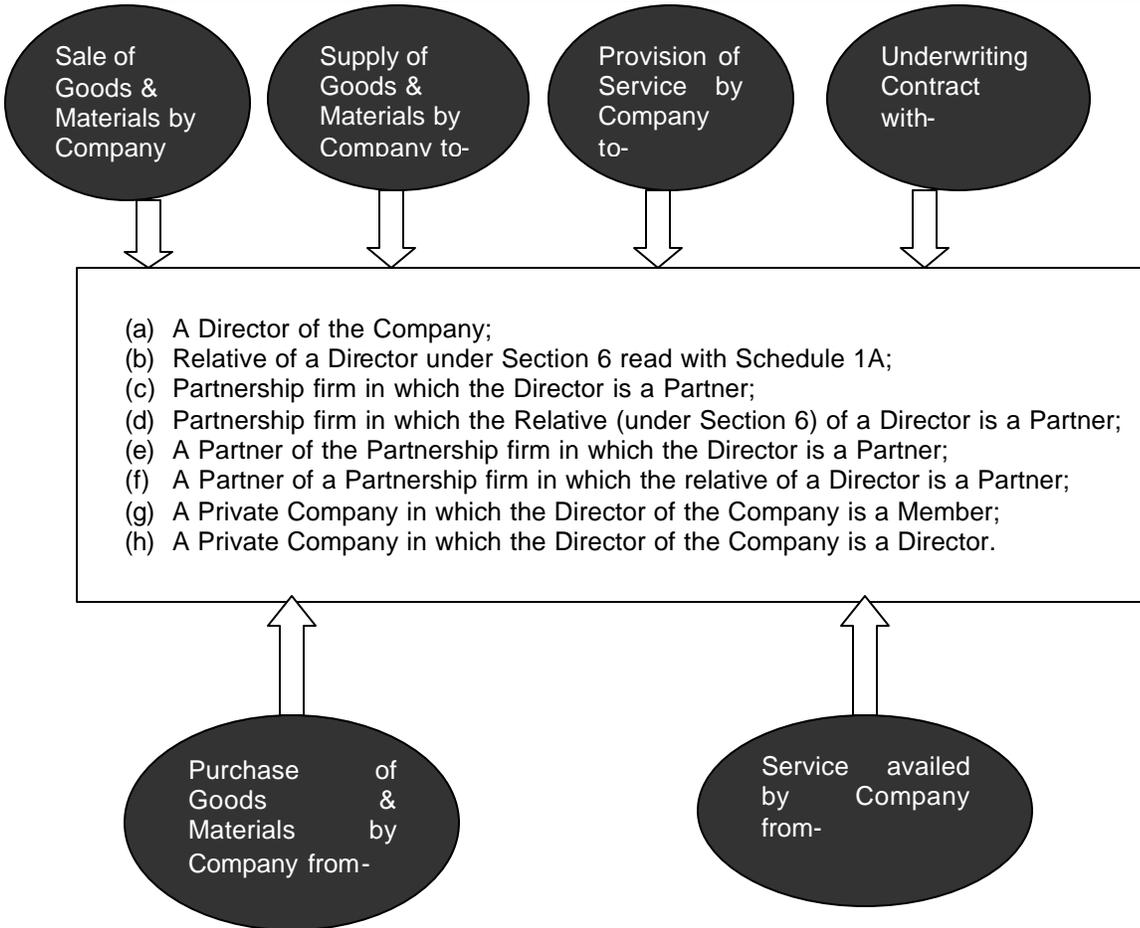
A.3 Transactions / Contracts that can be made without Board's approval:

- (a) ***For Cash at prevailing market prices:*** If the purchase or sale of goods and materials from or to any of the specified parties is for cash at the prevailing market prices. 'For Cash' should be understood in the context of 'cash sale' / 'cash purchase' as distinguished by a 'credit sale' / 'credit purchase', and that it is not necessary that the payment for the same should be made in cash, but can also be made by way of a cheque.

- **Providing or Availing Service not covered:** It is to be noted that, the aforesaid exception is available only in respect of purchase and sale of goods and materials and does not extend to providing or availing service from the specified parties. Also, this exception cannot be availed in respect of 'supply of goods and materials'. Supply of goods and materials would have to be understood in the context where the transaction does not tantamount to a 'Sale' or a 'Purchase'.
 - **When No 'Identical Goods' exists:** The requirement for the transaction 'for cash' at 'prevailing market prices' presupposes sale of 'identical goods', to other parties by the same party or by other parties. In situations where the Company, manufacturing a unique product (say a patented product or has a monopolistic presence in the market) and the Company has an exclusive marketing arrangement (EMR) with another entity where the Director or the other specified persons are interested, by sale of the product, the exemption under this clause would not be applicable, even if the sale/purchase is at arms-length for 'cash'.
- (b) **Routine business transactions:** If the purchase, sale or supply of goods, materials and service is one, which is a regular business of either the Company or any of the specified parties, and that the total value of such transaction in a year is either Rs. 5,000/- or less.

In the above, two instances, the provisions of Section 297 would not be applicable, and hence, there is no requirement for obtaining approval of the Board and/or Central Government, under the provisions of Section 297. **However, these transactions would come within the purview of Section 299 and hence, thereby would require an entry in the 301 Register.**

PIC 1.2 – TRANSACTIONS COVERED BY SECTION 297 FOR BOTH PUBLIC AND PRIVATE COMPANIES



PIC 1.3-THE OTHER PARTY NOT COVERED BY SECTION 297

- (a) Contract by a Public Company with another Public Company
 - (b) Contract with a Private Company in which a relative of a Director is a Director;
 - (c) Contract with a Private Company in which a relative of a Director is a Member;
 - (d) Contract with a Private Company in which a Partner of the Director is a Director;
 - (e) Contract with a Private Company in which a Partner of the Director is a Member.
- of the nature specified in PIC 1.2

A.4 Contract whether written or oral: It is not necessary that a contract with the specified parties should be in written form. If the auditor finds in the course of his audit that there are transactions with parties covered under the Section, he is required to verify whether there has been an approval of the Board in respect of the transaction, and whether the same has been entered in the Register of Contracts.

A.5 'Materiality' not material: It is an audit practice that the Auditor arrives at the 'Materiality' based on the turnover of the Company, and may not verify transactions the value of which are lesser than the 'material' amount. However, in respect of transactions, which attract the provisions of Section 297, the 'material' amount is Rs. 5000/-, and the auditor has to verify all transactions and ascertain whether the Board has approved the transaction and whether an entry is made in the 301 register, **so as to satisfy himself in respect of Para 4(v)(a) of CARO, 2003.**

A.6 Companies should be Indian Companies: A contract that an Indian Company enters into with a Private / Public Company incorporated outside India (where a Director is a Director or Member) for sale or purchase of goods or for a providing / availing a service will not be covered under this Section, as a Foreign Company is a Body Corporate as defined in Section 2(7) of the Companies Act, 1956 and the provisions of Section 297 are applicable only to transactions with a Company as defined in Section 3 of the Act, which is restricted to a Company incorporated in India.

A.5 Contract with a HUF: A contract with a HUF wherein the Director is the Karta or a Co-parcener, the contract will fall within the mischief of Section 297 and is not exempt from its provisions, as under Section 6(a) a person is considered to be a relative of another if they are members of a Hindu Undivided Family.

A.6 Additional information to be obtained by the Auditor for Section 297:

It is to be noted that under Section 299(3)(a), a Director is required to state only the following:

- (a) Companies (both Public and Private) in which he is a Director;
- (b) Companies (both Public and Private) in which he is a Member / Shareholder;
- (c) Partnerships firms in which he is a Partner.

With the information available on Form 24AA alone, the Auditor would not be in a position to determine whether any transaction attracts the provisions of Section 297.

Hence, the Auditor should obtain the following additional information:

- (a) Details relating to the business of the Director wherein he is a sole-proprietor;
- (b) Details relating to relatives of Directors;
- (c) Details of firms in which the relative is a Partner;
- (d) Names of the Partners in the firm in which the Director is a Partner;
- (e) Names of the Partners in which the Relative of a Director is a Partner.

Only if the Auditor is equipped with these information, would he be in a position to comment on the following requirement of CARO

- (a) whether the particulars of contracts or arrangements referred to in section 301 of the Act have been entered in the register required to be maintained under that section; and
- (b) whether transactions made in pursuance of such contracts or arrangements have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time

B. APPLICABILITY OF SECTION 299

This Section mandates that a Director should disclose his nature of interest or concern in a contract or arrangement to be entered into by a company. This disclosure is to be made to the Board of Directors of the Company. The Section casts an onus on the Director to state whether or not he is interested and also state as to his nature of the interest or concern.

B.1 CONTRACTS, ARRANGEMENT, INTEREST AND CONCERN: Section 299 is applicable not only to `Contracts`, but also to `arrangement`. The word `arrangement` is something that has a wider scope than Contract. A definition for the word `arrangement` can be found in Section 390(b) of the Act. However, the definition is applicable only to the word `arrangement` in Section 391 to 393, and cannot be extended to Section 299. In certain transactions the interest or concern of a Director is apparent, and the Auditor can conclude that the provisions of Section 299 are attracted. However, in certain transactions, the interest or concern may not be apparent. This would in most cases be transaction wherein there is an indirect interest or concern.

The words `Interest` or `Concern` are not defined in the Act, and it is to be reckoned with, in respect of each transaction. The `Interest` or `Concern` can be said to be present if there is any personal interest or a duty in the contract or arrangement that might come into conflict with the interest of the Company, whose interest the Director is bound to protect. [Ramjilal Baiswala V. Baiton Cables Ltd., ILR (1964) 4 Raj. 135].

An interest or concern is a matter which is to be determined with reference to the facts and circumstances of each contract and it is a matter of disclosure made by a Director.

B.2 The interest or concern referred to in this Section can be broadly categorised as:

- (a) Interest/Concern being a personal interest; and
- (b) Interest/Concern arising out of shareholding in a Company.
- (c) Interest/Concern arising out of Interest/Concern in a Foreign Company.

B.2.1 Interest/Concern being personal interest

A transaction wherein a Director has a personal interest in his individual capacity would attract the provisions of Section 299, and some such transactions are illustrated below in Pic 1.3.

PIC 1.3

ILLUSTRATIVE LIST OF TRANSACTIONS THAT WOULD FALL WITHIN SECTION 299.

MATTERS THAT ARE PERSONAL TO THAT OF A DIRECTOR

- (a) A Director being appointed as a Managing / Executive Director;
- (b) A Relative of a Director who is being appointed as Managing / Executive Director;
- (c) A Director or his relative is being appointed to an Office or a Place of Profit in the Company;
- (d) A Loan that is being made by the Company either to the Director, or his relative;
- (e) An investment being made by the Company in a firm in which a Director is a Partner;
- (f) A Contract for purchase or sale of immovable or movable property from or to a Director;
- (g) A Contract for taking on lease (of immovable property) by the Company, belonging to a Director;
- (h) A Contract for letting on lease (of immovable property) belonging to the Company, to a Director (if the property of the Company is being given as Rent Free Accommodation to the Director, 299 would not be applicable);
- (i) Allotment of shares by way of Preferential Allotment to a Director or his relative or an entity wherein he has a substantial interest;

It can be seen from the above, that in the transactions illustrated above, the Director has a direct personal interest and such matters would require an entry to be made in the Register under Section 301. It is likely that the Director may have an indirect interest in contracts wherein he has a personal interest. Indirect interest, are matters that can be ascertained only on disclosure and not otherwise, and it is surely not the duty of the auditor to probe as to whether a Director has an indirect interest or not, in any transaction.

B.2.2 Transaction with Company: In respect of a transaction with a Company, the 'interest' or 'concern' element is said to be present only if the director holds more than 2% of the paid-up share capital (**not voting rights, hence Preference Share Capital and Shares with differential voting rights should also be taken into account, apart from Equity**) in the other company.

Situation 1: Mr. D, is a Director in A PLC and B PLC, holding 5% and 2.1% of the paid-up share capital, respectively. If A PLC enters into a transaction with B PLC, the provisions of Section 299 is attracted, thereby warranting disclosure by Mr. D in both the Companies, and would appear in the 301 Register of both the companies.

Situation 2: Mr. D, is a Director in A PLC and B PLC, holding 5% and 2% of the paid-up share capital, respectively. A PLC enters into a transaction with B PLC.
In A PLC – The transaction **would not** attract the provisions of Section 299, as Mr. D is not holding more than 2% of the paid-up share capital of B PLC.

In B PLC – The transaction **would attract** the provisions of Section 299, as Mr. D is holding **more than 2%** in the other Company (i.e) A PLC, and the transaction should be entered in the 301 Register.

The test for exclusion on shareholding arises only in respect of `Contracts' and `Arrangements' with **Companies and does not include Foreign Company and other forms of Organisations**. Also, the 2% shares should be held by the `Director' (which would include shares where he has a beneficial interest, and those which are registered in his name but has no beneficial interest in them) and would not include those shares over which he is in a position to exercise `Control'.

An illustrative list of transactions between two companies that would fall within the ambit of Section 299 is given in Pic 1.4.

PIC 1.4

ILLUSTRATIVE LIST OF TRANSACTIONS THAT WOULD FALL WITHIN SECTION 299.

MATTERS BETWEEN TWO COMPANIES

- (i) A Loan by Company to another Company (Public or Private) in which Director is a Director or Member;
- (ii) An investment being made by the Company in another Company wherein a Director is a Director or a Member;
- (iii) One Company gives its machinery to another Company for use by the other Company, without any consideration.
- (iv) Any Contract between two Companies, which have common directors, and who in all hold 2% or more of the paid-up capital in both the Companies.

B.2.3 Interest/Concern arising out of Interest/Concern in a Foreign Company

The exemption from the operation of Section 299, arising out of shareholding in a Company, is applicable only in respect of **an Indian Company** and not in respect of a Foreign Company, since a Foreign Company is a "Body Corporate" under Section 2(7) of the Companies Act, 1956. Hence, any transaction that a Company has and if any Director has an interest, either by being a Director *Simpliciter* in the Foreign Company or having a shareholding even, if it is less than 2% in the Foreign Company, the provisions of Section 299 would get attracted, thereby requiring an entry in the Register under Section 301. An illustrative list of transaction between an Indian Company and a Foreign Company is given in Pic 1.5.

PIC 1.5

ILLUSTRATIVE LIST OF TRANSACTIONS THAT WOULD FALL WITHIN SECTION 299.

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MATTERS BETWEEN AN INDIAN COMPANY AND A FOREIGN COMPANY

- (a) A Contract with a Foreign Company for purchase or sale of goods, materials or for providing or availing a service; (Even though the provisions of Section 297 are not applicable for such transactions, the provisions of Section 299 are applicable).
- (b) External Commercial Borrowing (ECB) obtained from a Foreign (Holding) Company;
- (c) Contract for Technical Services, Consultancy Services, payment of Royalty etc.

B.3 All Transactions covered under AS-18 may not fall within the scope of Section 299:

It is not necessary that all transactions, which come within the scope of AS-18-Related Party Transactions, should fall within the mischief of Section 299. The test for determining whether a party is a related party or not under AS-18, is to be applied in relation to the Enterprise (i.e) the Company. However, the test for determining whether the provisions of Section 299 is applicable or not, is to be applied in relation to the Director.

B.4 For commenting upon Paras 4(iii)(a), 4(iii)(e) and 4(xvii) of CARO, 2003:

A point of distinction is also required to be made in the context of the discussion of contracts with Companies, while commenting upon the above-referred paragraphs of CARO, 2003. Since, the requirement in these paragraphs is to comment upon transactions with "Parties covered in register maintained under Section 301", even if the transaction is one which does not attract either Section 297 or Section 301, if there is a transaction with a Company, wherein a Director is only a Director, it would have to be commented upon by the Auditor, by virtue of the Company being a party whose name has been entered in Part 2 of the Register under Section 301, even though the transaction would not require an entry in Part 1 of the Register under Section 301.

CONCLUSION

It is possible that there can be a conflict between the statement of a Company Secretary in his Compliance Certificate and that of the Auditor in his Audit Report in matter concerning the Register under Section 301.

Under Para 10 of the Companies (Compliance Certificate) Rules, 2001 the Company Secretary is required to state whether "***the company has made necessary entries in the register maintained under section 301 of the Act.***"

CONCLUSION

Under Para 4(v)(a) of CARO, 2003, the auditor is required to comment “***whether the particulars of contracts or arrangements referred to in section 301 of the Act have been entered in the register required to be maintained under that section.***”

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It is to be seen that the Company Secretary is required to comment as to whether all necessary entries are made in the 301 register, which would include the provisions of Section 301(3) (Part 2 of the Register as mentioned in Pic 1.1). However, the auditor is required to comment upon only the particulars of the contracts or arrangements that are required to be entered in the 301 register by virtue of the transaction falling within the mischief of either Section 297 or 299. Hence, it is possible, if there are no transactions attracting Section 297 or 299, and there is a change in the disclosure made by the Director in his Form 24AA for two years, the Auditor would comment that “**There were no contracts or arrangements that are required to be entered in the register maintained under Section 301**”, and the Company Secretary would comment **The company has made necessary entries in the register maintained under section 301 of the Act.**”

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