

Audit committee's omnibus approval for related party transactions

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In this article, the author makes an attempt to analyse (i) the Companies (Meetings of Board and its Powers) (Second Amendment) Rules, 2015, (ii) the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ('the Listing Regulations') and (iii) variance in the Audit Committee's omnibus approvals under the Act and the Listing Regulations.

Introduction

1. The approval process of the related party transactions for all the companies (listed or unlisted) has been one of the most debated topics from the effective date of section 188 of the Companies Act, 2013 ('the Act'). The audit committees' omnibus approval for the related party transactions was more deliberated when the then Listing Agreement was amended to provide such approval since the Act did not contain the corresponding provisions, sub-section (4) of section 177 of the Act (relating to 'terms of reference of the audit committee') was amended by the Companies (Amendment) Act, 2015. On 14th December, 2015, the Ministry of Corporate Affairs issued Companies (Meetings of Board and its Powers) (Second Amendment) Rules, 2015 which provided for criteria and conditions for audit committee's omnibus approval under the Act.

Meaning of 'omnibus' in the context of approval of related party transactions

2. *Black's Law Dictionary* defines 'omnibus' as 'relating to or dealing with numerous objects or items at once; including many things or having various purposes'. In the context of the related party transaction, 'omnibus' refers to the collective approval of the transaction instead of the piecemeal/individual approval.

Mandatory constitution of audit committee

3. Rule 6 of the Companies (Meetings of Board and its Powers) Rules, 2014 relates to 'Committees of the Board' and it states that the Board of directors of every listed company and the following classes of companies shall constitute an audit committee (and nomination and remuneration committee) of the Board :

- All public companies with paid-up capital of Rs. 10 crore rupees or more
- All public companies having turnover of Rs. 100 crore rupees or more
- All public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding Rs. 50 crore rupees or more

Therefore, constitution of audit committee is mandatory for every listed company and certain class of unlisted public companies. Private company which is subsidiary of public company is required to constitute an audit committee where any of the above thresholds (paid-up capital, turnover and outstanding loans or borrowings or debentures or deposits) are breached.

Background to audit committee's omnibus approval for related party transactions

4. The audit committee's omnibus approval for related party transactions was introduced by SEBI¹ by an amendment to clause 49 of the Listing Agreement. The SEBI introduced² Listing Regulations effective from 1st December, 2015. Pursuant to sub-regulation (2) of regulation 23 of the Listing Regulations, all related party transactions shall require prior approval of the audit committee, whether material or significant or of any transaction value. Sub-regulation (3) of that regulation states that the audit committee may grant omnibus approval for related party transactions proposed to be entered into by the listed entity and accordingly certain criteria are prescribed.

Provisions of audit committee's omnibus approval for related party transactions in the Act

5. The provisions relating to audit committee's omnibus approval for related party transactions were not there in the Act. With an objective of aligning the Act with SEBI Policy (then Listing Agreement) and increasing the ease of doing business, the Union Cabinet in its meeting held on 2nd December, 2014³ approved 14 amendments in the Act. Accordingly, the Act was amended vide the Companies (Amendment) Act, 2015, wherein a proviso was inserted to one of the terms of reference of the audit committee. The terms of reference relating to the approval or any subsequent modification of transactions of the company with related parties was amended by inserting a proviso, wherein the audit committee was authorised to make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as may be prescribed.

Analysis of the amendment to Companies (Meetings of Board and its Powers) Rules, 2014

6. With an objective of prescribing conditions for omnibus approval for related party transactions, Ministry of Corporate Affairs amended the Rules by inserting rule 6A titled as 'Omnibus approval for related party transactions on annual basis'. Following is the breakdown analysis of the Companies (Meetings of Board and its Powers) (Second Amendment) Rules, 2015 :

- All related party transactions shall require approval of the audit committee, i.e., the whether or not the transaction is in the ordinary course of business or at arms' length basis.
- It is not obligatory for the audit committee to grant omnibus approval for all related party transactions. i.e., it is not necessary that repetitive related party transactions within a prescribed monetary value be sanctioned by omnibus approval. Such transactions in can be approved on individual transaction basis.
- However, if the audit committee proposes omnibus approval for related party transactions, it is necessary to comply with the prescribed terms and conditions and criteria.
- For granting prior omnibus approval, it is necessary that the audit committee prescribes the following criteria and the particular related party transaction falls within the prescribed threshold/criteria :
 - Maximum value of the transactions, in aggregate, which can be allowed under the omnibus route in a year
 - Maximum value per transaction which can be allowed
 - Extent and manner of disclosures to be made to the audit committee at the time of seeking omnibus approval
 - Review, at such intervals as the audit committee may deem fit, related party transaction entered into by the company pursuant to each of the omnibus approval made
 - Transactions which cannot be subject to the omnibus approval by the audit committee
- At the time of granting omnibus approval, it is necessary for the audit committee to consider the following factors while specifying the criteria for making omnibus approval:
 - Repetitiveness of the transactions (in past or in future)
 - Justification for the need of omnibus approval
 - Need for omnibus approval for transactions of repetitive nature
 - Whether such approval in the interest of the company
- The amended Companies (Meetings of Board and its Powers) Rules, 2014, provides that the omnibus approval shall contain or indicate some prescribed points. Due to absence of clarity on the precise corporate secretarial practice, it is necessary that the audit committee's resolution granting omnibus approval shall contain the following points:
 - Name of the related parties
 - Nature and duration of the transaction
 - Maximum amount of transaction that can be entered into
 - Indicative base price or current contracted price and the formula for variation in the price, if any
 - Any other information relevant or important for the audit committee to take a decision on the proposed transaction
- Where the need for related party transaction cannot be foreseen and aforesaid details (i.e., name of related parties, nature and duration of transaction, maximum amount of transaction that can be entered into, indicative base price or current contracted price and the formula for variation in the price, if any; and any other relevant information) are not available, the audit committee may make omnibus approval for such transactions subject to their value not exceeding Rs. 1 crore per transaction. Since, the monetary limit is prescribed for 'per transaction', a company can enter into multiple transactions with the same related party for a value not exceeding Rs. 1 crore per transaction.
- Audit committee's omnibus approval shall be valid for a period not exceeding one financial year and shall require fresh approval after the expiry of such financial year.
- Audit committee's omnibus approval shall not be made for transactions in respect of selling or disposing of the undertaking of the company. Therefore, in such a case the company is required to obtain separate approval of audit committee, as such transaction is outside the purview of omnibus approval. Pursuant to the provisions of clause (a) of sub-section (1) of section 180 of Act, the Board of directors shall exercise the powers, for sale or disposal of company's undertaking, only with the consent of the company by a special resolution. Such approval of Board of directors and shareholders and not audit committee's omnibus approval is required only when the transaction is a 'related party transaction'.

Analysis of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

7. Regulation 23(3) relates to the audit committee's omnibus approval for related party transactions. The audit committee may grant omnibus approval for related party transactions proposed to be entered into by the listed entity subject to the following conditions :

- In line with the policy on related party transactions of the listed entity, the audit committee shall lay down the criteria for granting omnibus approval.
- Audit committee's omnibus approval shall be applicable in respect of transactions which are repetitive in nature.
- Audit committee shall satisfy itself regarding the need for such omnibus approval.
- Audit committee shall satisfy whether such omnibus approval is in the interest of the listed entity.
- The omnibus approval shall specify the certain points. Such points shall be included in the audit committee resolution. Certain points for

inclusion are : (i) name(s) of the related party, nature of transaction, period of transaction, maximum amount of transactions that shall be entered into, (ii) indicative base price/current contracted price and the formula for variation in the price if any ; and (iii) such other conditions as the audit committee may deem fit,

- Where the need for related party transaction cannot be foreseen and aforesaid details are not available, the audit committee of listed entity may grant omnibus approval for such transactions subject to their value not exceeding Rs. 1 crore per transaction.
- Listed entity's audit committee shall review, at least on a quarterly basis, the details of related party transactions entered into by the listed entity pursuant to each of the omnibus approvals given.
- Listed entity's audit committee's omnibus approvals shall be valid for a period not exceeding 1 year and shall require fresh approvals after the expiry of one year.

Variance in audit committee's omnibus approvals under the Act and the Listing Regulations

8. On comparison of the provisions of regulation 23 of the Listing Regulations with the Companies (Meetings of Board and its Powers) (Second Amendment) Rules, 2015 ('the Second Amendment Rules'), following are two variation in omnibus approval of related party transactions :

- With respect to review of related party transactions for which omnibus approval is granted, the Listing Regulations state the review shall be at least on a quarterly basis regarding the details of related party transactions entered into by the listed entity pursuant to each of the omnibus approvals given. Pursuant to the Second Amendment Rules, the audit committee shall review the related party transactions for which omnibus approval is granted at such intervals as the audit committee may deem fit. Therefore, audit committee of listed entities are required to review the transactions on quarterly basis and audit committees of unlisted public companies are required to review the transactions at such intervals, as it may deem fit.
- Pursuant to the Second Amendment Rules, the omnibus approval for related party transactions shall not be made for transactions in respect of selling or disposing of company's undertaking. However, there is no such restriction in the Listing Regulations. Since the Second Amendment Rules are applicable to all companies, such restriction is applicable to listed companies as well.

Conclusion

9. In the Second Amendment Rules, the terms and conditions for audit committee's omnibus approval relating to related party transactions have been stipulated. Therefore, audit committees of unlisted public companies, along with listed companies, can now give an omnibus approval for the related party transactions. It is also noteworthy that there is significant unanimity and less of variance in the Second Amendment Rules and the Listing Obligations Regulations with respect to the omnibus approval by audit committee.

FOOTNOTES

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1. Vide SEBI Circular No. CIR/CFD/POLICY CELL/7/2014 dated 15th September, 2014.

2. Vide SEBI Press Release No. 226/2015 dated 3rd September, 2015.

3. PIB Press Release dated 2nd December, 2014.

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