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July 2020

CMAs' INDUSTRY BULLETIN

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

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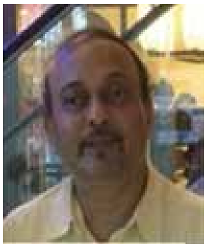
ENVIRONMENTAL & SOCIAL GOVERNANCE AND SUSTAINABILITY - AN INDUSTRY PERSPECTIVE



CMA P. K. Chakravarty
Practicing Company Secretary and
Management Consultant & Corporate Counsel, Kolkata

Environmental & Social Governance (***ESG***) are emerging factors that establish the frame work for assessing the impact of sustainability and ethical practices of a Company on its financial performance and operations. In the present competitive world of trade & business one cannot undermine the impact and conformance of many regulatory requirements that encompass an organization. Equally important is the need for sustainability with discipline and dignity and the need for a reasonable conformance of ESG norms for industries from the standpoint of long term growth, viability and sustainability of industries.

Initially, the ESG framework was only used by some investors to observe if they were investing in a suitable business. In recent times, the ESG frame work has gained more recognition among the investors because of the greater attention of Governments & Regulators to environmental and social factors and a stronger public awareness of environmental and social influence a Company has on society at large.

Essentially, ESG is a set of criteria or standards for a Company's operation that socially conscious investors use to assess potential investments. Environmental criteria consider how a Company operationally performs respecting the different conditions of nature. Social criteria examine how a Company manages its relationships with employees, suppliers, customers and the community where it operates. Governance deals with the Company's leadership, internal controls and stakeholder rights. Thus, ECG refers to the three central factors in measuring the sustainability and ethical impact of investment(s) in respect of a Company's business so as to help examine and determine how well the Company will perform financially in the future.

Many in the investment industry believe that gradual development of ESG factors as major consideration in investment analysis in the near future. The evidence towards a relationship between the consideration for ESG issues and financial performance is becoming greater and the combination of fiduciary duty and wide recognition of the necessity of sustainability of investments in the long run has meant that environmental, social and governance concerns are becoming increasingly important in the investment market.

The three pillars of ESG may be articulated as under :

Environmental Factors :

These are primarily concerned with the Company's influence on the surrounding environment and its ability to mitigate various risks that could harm the environment. Generally, a Company is assessed by its use of energy, waste reduction, level of pollution control, efficient utilization of resources, natural resource conservation, management of toxic emissions, etc. Regulators around the world have introduced strict environmental policies and a Company's inability to comply with such standards may result in significant penalties. In addition, a Company's irresponsible environmental response may damage the area of its operation and subsequently limit the Company's operating capacity and its financial performance too.

Social Factors :

The social factors look into the Company's relationship with the society and community at large. Social factor considers the attitude towards diversity, human rights and consumer protection. The social factors may affect the Company's operational success by attracting new customers and retaining their loyalty; maintaining healthy relationship with business partners (including suppliers & employees) and the communities.

Corporate Governance Factors :

These are concerned with the management of internal affairs of the Company and the relationship with various stakeholders. Efficient and transparent corporate governance can help avoid conflicts of interest between the Company's stakeholders and consequent litigation expenses. Good corporate governance by a Company also helps to enhance its reputation, goodwill, creditworthiness and long term prosperity. From the standpoint of the investors, they want to understand that the Company uses correct and transparent accounting methods, follows all applicable Rules & Regulations and conforms to fair & ethical practices in all business dealings.

Factors & Events that undermine the effectiveness of ESG :

1. **Environmental concerns –**

   Under this head following important factors may be included :

   (a) Climate change concern :

   Various research in recent times providing evidence of global trends with regard to climate change has led investors to examine potential impact on investments in terms of perceived factors of climate change. For instance, fossil fuel based industries are less attractive now. Global investors at present emphasise the necessity of including consideration of climate change and environmental issues in all financial calculations for better understanding of the viability of a project in a given situation.

   (b) Nuclear energy concern :

   Responsible investing often choose to dissociate from firms associated with the construction of nuclear power plants because of possible environmental hazards impacting operational efficacy .

   (c) Sustainability concern :

   Environmental sustainability is a big concern for leaders while formulating business strategies. Ensuring the right sustainability practice makes a business more environment friendly and more profitable in the long run.

2. **Social concern :**

   (a) Diversity concern :

   The level of inclusion in a Company's recruitment policy is becoming a key concern to investors. There is growing perception that greater the number of talented people open to an employer, the greater is the chances of finding the optimum person for a job. Innovation & agility are seen as the great benefits of diversity.

   (b) Human rights concern :

   In the past Companies tended to approach social issues through their routine CSR programs. And many CSR initiatives were undertaken selectively, based on the Company's own priorities. A human rights approach requires Companies to respect the human entity with ethical values focusing universally recognized people – cantered approach in the pursuit of social and environmental obligations. And a corporate showing this attitude is preferred by the investors for long term association.

   (c) Consumer protection concern :

   This is linked to the universally accepted consumer rights and to the formation of consumer organizations which help consumers make better choices in the market place. In recent times ,there has been an increased acceptance globally that the consumer has a right to a degree of protection and the vast growth in the number of consumer rights related litigations indicate that consumer protection is one of the central considerations for those seeking to examine a Company's credentials for the purpose of investing.

3. **Corporate Governance concern :**

(a) *Management structure :*

A normal corporate structure consists of various departments that contribute to the Company's overall mission & goals. There is a great diversity in corporate structures as enterprises may range from a simple corporate structure to a multi – corporate conglomerate. Most corporate tend to have a hybrid structure which is a combination of different models with one dominant strategy. The system of internal procedures and controls that makes up the management structure of a Company impacts to a large extent the Company's valuation too which the investors carefully evaluates. Investors' attention has also been focused in recent years on the balance of power between the CEO and the Board of Directors & Chairman in an organization.

(b) *Employee relations :*

From diversity to the establishment of corporate values , the role that improving employee relationships play in assessing the intrinsic worth of a Company is proving increasingly important for the reason that such criteria attracts talent and retain them and enhances Company values which investors prefers from a long term perspective.

(c) *Executive compensation :*

Remuneration being paid to top level executives in the recent years are carefully observed by the stock holders, Regulatory Authorities and investors from thestandpoint of good governance of Company affairs & consequent performance of the Company.

(d) *Employee compensation :*

Beside executive compensation, equitable pay for other employees is also a consideration in the governance of an organization. This includes pay equity for employees across genders, caste & creed. Information with regard to pay equity and fair pay is also one of the factors that investors in recent times take into consideration while determining the ethical values of an organization before finalizing any investment decision.

Responsible Investment & Investment Strategies – an ECG driven perspective

The three concepts of social, environmental and corporate governance are intimately linked to the concept of Responsible Investment .Responsible Investment began as a niche investment area serving the needs of those who wished to invest but wanted to do so with ethically defined parameters .In recent years, this change in mindset amongst the investors have become quite predominant as many research initiatives in this regard carried out globally have established.

In this context, Responsible Investment has the following critical features :

- **Activism** : Strategic voting by shareholders in support of a particular issue or to bring about change in the governance of a Company for the purpose of enhancing the stakeholders value.
- **Engagement** : Monitoring the ESG performance of the Company and / or its constituent units and ensuring stakeholders engagement thereto for ensuring progress in this area.
- **Consulting** : Institutional investors and shareholders should be able to engage with top management to exchange information as to ESG related matters and to initiate action at the right time when any potential governance issues or major risks are perceived.
- **Exclusion** : The removal of certain sectors or Companies from consideration for investment , based on ESG –specific criteria.
- **Integration** : The inclusion of ESG risks & opportunities into traditional financial analysis for determining equity values and arriving at company valuations.
- **Positive selection** : While selecting Companies for investment , investors follows a defined set of ESG criteria or the best – in – class method where a subset of high performing ESG compliant companies is chosen for inclusion in an investment portfolio.

The Principles of Responsible Investment (PRI) initiative was established in 2005 by the United Nations Environment Program Finance Initiative and the UN Global Compact as a framework for improving the analysis of ESG issues in the investment process and to aid companies in the exercise of responsible ownership practices. As of April 2019, there were over 2350 PRI signatories. Further, in response to investor interest in ESG, private equity and other industry trade associations have developed a number of ESG best practices , including due diligence questionnaire for private fund managers and other asset managers to use before investing in a portfolio Company.

Equator Principles :

Equator Principle is a risk management framework adopted by Financial Institutions for determining, assessing and managing environmental and social risks in project finance. It is primarily intended to provide a minimum standard for due diligence to support responsible decision making in the context of potential and emerging risks a Company may encounter from social , environmental and governance fronts. The industry – specific due diligence criteria prescribed for various industries serves as a reliable guideline for the Progressive Financial Institutions globally to decide on extending credit or sanctioning loans to Companies who do not follow or have a history of default in complying with the specific norms established for their environmental or social or general governance criteria.

The Equator Principle, formally launched in Washington DC on June 4 2003 , were based on standard environmental and social policy frameworks established by the International Finance Corporation (IFC) . These standards have subsequently been updated from time to time and are now commonly known as International Finance Corporation Performance Standards on Social and Environmental sustainability and also form a part of World Bank Group Environmental, Health and Safety Guidelines.

Issues of ESG : A Global perspective

One of the major issues in the ESG area is **standards** for disclosure. Environmental risks created by business activities have actual or potential negative impact on air, land, water, ecosystems and human health. The information on which an investor makes his decision on a financial level is gathered conveniently and are reasonably reliable in as much as these financial information are audited and professionally authenticated. On the other hand, ESG related information are generally Company's own figures and unverifiable as these are in most cases not authenticated by any independent responsible authority.

Further, lack of universal standards & regulations as to the disclosure of environmental , social & governance practices implies that the preparation and measurement of such statistics tend to be extremely subjective and in most cases , highly biased.

Furthermore , the need for integrating ESG information into investment analysis and calculation of a Company's value thereof has become more prevalent in recent times by global investors but to provide the unit or criteria of measurement of various critical subjective issues that govern environmental & social dimension of a business under the ESG is difficult and there is no consensus as yet on these , so to say , companies use varied measurement tools & methodologies to articulate these subjective factors in a way they believe will best suit their organizational value. This lack of uniformity and objectivity poses a great hindrance in properly integrating the ESG criteria in the financial analysis of an organization and thus many times the investors find it extremely difficult to arrive at a correct and objective investment decision under the ESG perspective.

One of the solutions put forward to reduce the subjectivity of ESG data is the provision for adoption of universally accepted standards for the measurement of some of the main ESG factors. Organization as the ISO (International Organization for Standardization) provide highly researched and widely accepted standards for many factors of ESG. Some investment consultancy firms, for instance, Probus- Sigma have created methodologies for calculating the ratings for an ESG based Rating Index that is based on ISO standards and is externally verified. But the formalization of the acceptance of such standards as the basis for calculating and verifying ESG disclosures is by no means universal and lacks statutory force resulting in divergence and discretion in the process of disclosures amongst many Companies scouting for funds in the global investment market.

There is some movement in the insurance market to find a reliable index of ratings for ESG issues with some suggestions from the ISO that the future lies in the construction of algorithms for calculating ESG ratings based on ISO relevant ISO standards and third party verification.

Further, the standards established under the World Trade Organizations (WTO) with regard to ESG mandates that all members follow these guidelines in the right earnest. Similarly , General Agreement on Tariffs and Trade (GATT) specifies clauses of Most Favoured Nation Principle and National Treatment Principle which puts an obligation on the member countries to treat all other states equally without any discrimination , thus , upholding the ethos of equity & justice , the cornerstone of social governance beyond the political boundaries of a nation.

Two other indices are also used by Companies from the standpoint of measuring Sustainability Practices taking into consideration the various ESG factors. They are :

(a) The Dow Jones Sustainability Indices (DJSI World) –

The DJSI assesses Companies on corporate governance, environmental & social performance and sustainable business practices. Over the last few years many Indian Companies have adopted strategies that help their business achieve long term growth while protecting and preserving the environment.

(b) *The Sustainability Accounting Standard Board (SASB) -*

SASB connects business and investors on the financial impact of sustainability. SASB's mission is to help business around the world identify, manage and report on the various sustainability issues & factors that matter most to their investors.

Essentially, *corporate sustainability* implies the ability of companies to positively influence environmental, social and economic development through their governance practices and market presence.

The ESG Disconnect : Disappointment for Investors looking for ESG Connect

A major struggle facing Companies in the context of providing information for ESG factors that encounter them is the communication gap between the Companies and the investors. Investors globally look for standardized data on ESG that they can use to compare performance, viability and growth potential across a number of similar Companies, preferably, in the same industry. Since the priorities in respect of the ESG factors amongst Companies vary widely, the weight age given by the respective management of these Companies to their ESG factors also vary far & wide and from year to year and between management teams of the same Company, thus, defeating the very purpose of arriving at a reasonable conclusion in respect of organizational value by the Investors.

In many cases information disclosed on ESG factors are not what investors are interested in as they struggle to determine the Company's efforts towards ESG risks. Even if the Annual Corporate Sustainability Report includes sustainability data that is aligned with long term risk management – certain useful information as : carbon use in energy intensive industries ; employee turnover rates ; material usage efficiency ; employee productivity ; effectiveness of health , safety & welfare measures on employees ; environmental awareness amongst employees ; customer satisfaction index ; etc. are not properly integrated with core decision making base –information of many Companies. It has been observed that these and other host of ESG related information usually do not form a part of the Company's strategy development or business plan information. As such, from the perspective of ESG, a Company cannot give a unified message on ESG initiatives. A comprehensive research undertaken by the University of California recently shows that most of the Companies scouting for cross-border investments fail to include their ESG risks factors and the risk mitigating strategies thereof into their overall business strategy statements.

Concluding Observations :

Mere incorporation of sustainability and other governance practices in the corporate mission & vision statements ma y not suffice; it requires sincere commitments. Mere reflection of social governance initiatives in the organization's Business Sustainability Report is a mirage; actual steps taken by the management to ensure its enforceability is what investors look for .The sad part in the overall movement of ESG initiatives is that the need for ESG compliance is yet to find a rightful place in the statue like CSR under the Companies Act and corporate governance under SEBI .

The environment and social governance is an ongoing process; it needs to be deep rooted and imbibed as a culture of the organization which will ultimately contribute towards nation building. Companies that are getting it right on ESG compliances have identified the elements which are ESG – related risks in a given situation and embedded them into their long term value creation story. Since ESG issues are likely to impact an organization's present and future business model, the forward – going organizations are integrating their values, goals and metrics into their long term business strategies to mitigate ESG risks. These organizations are also in the forefront for innovations, seeking new opportunities and finding new avenues of cost reduction. The need is to align the overall corporate responsibility efforts with the Company's long term strategy and purpose statement and present the same in a cohesive form to ensure confidence, trust and reliability in the organization's potential to create value for the society at large. Needless to say, in recent times global investors and International Financial Institutions, while considering investments, are essentially looking for these insights apart from the financials of a Company.

The author may be reached at
pratap_kr17@rediffmail.com

ROI ON HUMAN CAPITAL - A CLINICAL APPROACH OF MEASUREMENT

CMA (Dr.) Girish Jakhotiya
Chief Consultant
Jakhotiya & Associates, Mumbai

It has been a proven fact that it is the "human capital" of an organization that makes the ultimate differentiating impact in its life - cycle. Therefore, worldwide the accountants with their counterparts from the other functions, have been struggling to measure the returns from the employment of human capital. The HR - executives, obviously have been hosting & facilitating this critical and yet very interesting project of computing the ROI on Human Capital. There have been many qualitative & philosophical attempts conducted to measure this important phenomenon, without an adequate objectivity. Of course, one common challenge in this process of measurement is distinguishing between the impact of human excellence and technological excellence. Yet, the computation of 'ROI on human capital' is strategically, operationally, financially & culturally very important.

Broadly there are ten reasons why we should measure the 'ROI on human capital' & these are as follows:

1. Benchmarking & evaluation of the overall performance of the human resources of an organization
2. Human Resource Valuation (HRV) as a critical component of Business Valuation
3. Defining 'collective incentive' for a business or functional unit
4. Measuring viability of a unit
5. Change in the business model
6. Control on employee cost
7. Organizational Differentiation based on the quality of human resources
8. 8. Manpower Planning
9. Decision about process automation and
10. Developing entrepreneurial rigor across the organization.

A clinical approach to this measurement should pragmatically combine both, the financial parameters & the operational or qualitative details. Therefore, we basically need to define the financial measurement of «human capital». There are three alternate definitions possible, using the simple equation of " investment is equal to capital". The first definition is based on the discounted value of the investment to be made in the human resources during the next ten years, inclusive of the cost of capability development. Here the discounting rate may be equal to the "weighted average cost of capital" of the organization. The second definition of human capital is the first definition multiplied by a "composite performance index" which distinguishes the organization's human resources from those of the competitors. This second definition should be more suitable for comparing the ROI on human capital used by two comparable business verticals or plants or regions.

The third definition of human capital is based on a short-term view & contemporary factors impacting it. It is the annual investment made in the human resources. Whichever definition we use, we must observe the accounting principles of consistency and comparability. When we attempt to measure the ROI on the human capital invested in a function or a plant or a vertical, we need to treat this performance centre or unit as an " investment centre" (a concept wider than the "profit centre"). To facilitate the use of "investment centre concept", we can define & prepare a notional balance sheet of the performance centre or the unit. The human capital may also be defined by the levels or bands of the employees, to measure the ROI categorically.

After defining the 'human capital', we need to define the "return" or revenue or profit from the deployment of such capital. This too can be defined alternatively, based on the purpose and data availability. The most dependable definition can be "operating profit" contributed by a business or functional unit. This profit may be real or notional. The notional profit would depend on either market - based pricing of the functional services or ROI - based transfer pricing mechanism.

Another definition of this ' return' could be the " value addition" done by the employees of a unit. This value addition may be an absolute financial calculation or a "composite performance index" comprising of both, quantitative & qualitative components of the output given by the employees.

The ROI on the human capital may further be viewed with reference to the various aspects of organization's ethos, market or country wise peculiarities, other nonhuman value boosters in the organization, various milestones of its life - cycle, various stages of technological advancement etc. Instead of waiting endlessly for a perfect measurement of this vital ROI, we should pragmatically settle down on a reasonable computation. This is simply because, "something is better than nothing!"

Note

For a detailed discussion on "Human Resource Valuation & Accounting", readers can refer to a book written by the author- "Practical Aspects of Human Resource Management."(available on Amazon)

The author may be reached at
girishjakhotiya@gmail.com

"UNREGISTERED COMPANIES" UNDER COMPANIES ACT, 2013

Hareesh Kumar Kolichala
Chief Manager (Law)
Union Bank of India, Kolkata

The Companies Act, 1956 ruled the field for more than 50 years and presently Companies Act, 2013 is in force. Companies Act deals with various issues of formation, registration, operation, winding up and dissolution of companies. The provisions of the Companies Act, 2013 are applicable to companies that are registered under the Act. In fact, Section 11 of the repealed Companies Act, 1956 prohibited associations and partnerships exceeding ten persons from carrying on the business of banking and twenty persons for any other business unless it is registered as a company under the Act. Every member of a company, association or partnership carrying on business in contravention thereof shall be personally liable for all liabilities incurred in such business.

Similar provisions have been incorporated under the new Companies Act, 2013 too in Section 464 thereof. However, unlike the Companies Act, 1956, the Act itself did not prescribe any number. Sub-Section 1 of Section 464 stated that no association or partnership consisting of more than such number as may be prescribed shall be formed for the purpose of carrying on any business or partnership unless it is registered as a company under this Act or is formed under any other law for the time being in force. However, the proviso thereto indicated that such number of persons as may be prescribed shall not exceed one hundred. Rule 10 of the Companies (Miscellaneous) Rules, 2014 prohibited any association or partnership consisting of more than 50 persons for the purpose of carrying on any business. The said rule reads as under:

Association or partnership of persons exceeding certain number. - No association or partnership shall be formed, consisting of more than fifty persons for the purpose of carrying on any business that has for its objects the acquisition of gain by the association or partnership or by individual members thereof, unless it is registered as a company under the Act or is formed under any other law for the time being in force."

While Companies Act, 1956 had made a distinction between Banking business and any other business whereas the said Rule 10 did not make any such distinction and prescribed 50 members as the maximum to carry on any business without registration under the

Act. The said rule therefore mandates that association or partnership or individual members consisting of more than 50 persons for the purpose of carrying on any business will have to be compulsorily registered under the Companies Act,2013 lest the same shall be an illegal association.

Section 9 of the Companies Act,2013 provides about the effect of Registration of companies under the Act as under:

"From the date of incorporation mentioned in the Certificate of incorporation, such subscribers to the memorandum and all other persons, as may, from time to time, become members of the company, shall be a body corporate by the name contained in the memorandum, capable of exercising all the functions of an incorporated company under this Act and having perpetual succession with power to acquire, hold and dispose of property, both moveable and immovable, tangible and intangible, to contract and to sue and be sued, by the said name."

While it being so, interestingly, Chapter XXI of the Companies Act, 2013, under Sections 375-378, also dealt with "Unregistered Companies". It is analogous to Sections 583-589 of the repealed Companies Act,1956.

APPLICABILITY OF THE COMPANIES ACT,2013 TO "UNREGISTERED COMPANIES":

The proviso to Section 377 states that an unregistered company shall not be deemed to be a company except for the purposes of winding up as per the provisions of the Act.

Therefore, it is clear from the above that the provisions related to winding up of Companies registered under Companies Act.2013 are applicable to the Unregistered Companies only for their winding up. Only to that extent, the said unregistered companies are treated as Companies registered under the Companies Act, 2013.

WHAT IS AN UNREGISTERED COMPANY? :

The expression "Unregistered Company" has not been defined by the Act. It can be understood that an "Unregistered Company" is a Company which is not registered under the Act. Explanation (a) to Section 375 of the Companies Act,2013 describes the companies which are not Unregistered Companies as under:

For the purposes of this part, the expression, "unregistered company"

a) shall not include
   i. A railway company incorporated under any Act of Parliament or other Indian law or any Act of Parliament of the United Kingdom.
   ii. A Company registered under this Act; or
   iii. A company registered under any previous companies law and not being a company the registered office whereof was in Burma, Aden, Pakistan immediately before the separation of that country from India; and

Explanation (b) thereof defines unregistered companies as under:

b) Save as aforesaid, (unregistered companies) shall include any Partnership firm, limited liability partnership or society or co-operative society, association or company consisting of more than seven members at the time when the Petition for winding up the partnership firm, limited liability partnership or society or co-operative society, association of company, as the case may be, is presented before the Tribunal.

Therefore, an "unregistered company" shall include any partnership firm, limited liability partnership or society or co-operative society, association or company consisting of more than seven members at the time when the Petition for winding up the partnership firm, limited liability partnership or society or co-operative society, association or company.

However, it is not clear from the Act as to the need to provide for the winding up of Partnership firms, LLPs, Societies or association of persons. Sections 39-55 of the Partnership Act, 1932 provided various provisions for dissolution/winding up of Partnership firms. Similarly, Sections 63-65 of the LLP Act, 2008 and Limited Liability Partnership (Winding up and dissolution) Rules, 2010, which came into force from 30.3.2010 provided for elaborate procedure for winding up of LLPs. No other enactment dealt with the issues which are subject matter of other enactments. The Acts like Partnership Act, 1932 etc. do not contain provisions for winding up of companies registered under the Companies Act,2013. But, we may gather the objective behind inclusion of these provisions in the companies Act from the judgment of Karnataka High Court in the case of G.P. Ganapaiah Maiya and Ors. vs. M.T.R. Associates and Ors.[[1986]59CompCas359(Kar)] wherein the High Court had observed as under:

"The two decisions relied upon by Mr. Krishna Murthy do not support the proposition that this court cannot wind up the respondent company or similar association of person answering to the description of a deemed company under the Companies Act merely because there is another forum by which the dispute can be settled. I am of the view that deemed companies, including an unregistered firm of partnership consisting of more than 7 persons, have been subjected to on bularge number of partners involved and the duration of civil litigation that may protract the proceedings of dissolution in a civil court.

Proceedings under the Companies Act are summary in character and is a speedier way of safeguarding the interest of the partners or other persons who have formed themselves into an association of person answering to the description of "deemed companies" under the Act to settle their mutual rights as well as public interest if it is involved. It may be in some cases such companies may owe debts to third parties-creditors whose interest also is to be safeguarded instead of driving them to civil litigation.

If the argument of MR. Krishna Murthy is to be accepted, then, other creditors' petitions under section 433 of the Companies Act should also be referred to the civil court because there is a forum to agitate the claim of the creditor. I do not think such an approach would be the correct approach. Parliament in its wisdom has enacted Part X of the Companies Act."

WHEN AN UNREGISTERED COMPANY MAY BE WOUND UP:

Sub-Sections (2), (3) and (4) of Section 375 provides the circumstances under which an Unregistered Company can be wound up. Section 375(2) provides that no unregistered company shall be wound up under this voluntarily. Section 375(3)(a) provides that if the company is dissolved, or has ceased to carry on business or is carrying on business only for the purpose of winding up its affairs, (b) if the Company is unable to pay debts and (c) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

WHETHER THE JURISDICTION OF CIVIL COURTS IS BARRED FOR DISSOLUTION OF PARTNERSHIP :

In the case of Vasant Rao Vs.Shyam Rao [AIR1977SC2021], it was held by the Supreme Court that Section 590 of the Companies Act,1956 was a saving provision which left unaffected operation of any other enactment and hence the Civil Courts are also competent to entertain matters regarding dissolution of partnership firms under Partnership Act,1932. This makes clear that the aggrieved party either has a recourse under the Companies Act or under the Partnership Act.

WHETHER AN UNREGISTERED COMPANY CAN BE WOUND UP IF IT IS FORMED IN VIOLATION OF Rule 10 of the Companies (Miscellaneous) Rules, 2014?:

As discussed above, the said rule 10 provides that an association of persons or partnership firms etc. cannot be formed without registration under the Companies Act,2013, if the number of members is more than 50. The moot question is whether an unregistered company having more than 50 members or less than 7 can be wound up as an Unregistered Company as per the provisions of the Act?

In the case of Bangalore Timber Industries and ors. Vs.Madras Sapper Ex-Servicemen's Rehabilitation Association [1987(3)KarLJ496], an objection was raised against the proceedings of winding up of the Society Registered under Societies Registration Act,1860, which was consisting of more than 20 members whereas under section 11 of the Act, no company, association or partnership consisting of more than 20 persons shall be formed for the purpose of carrying on any business that has as its object the acquisition of gain by the company, association or partnership, or by the individual members thereof, unless it is registered as a company under this Act, or is formed in pursuance of some other Indian law.

However, Karnataka High Court had held that there was no bar for maintaining the petition of winding up of the Society and held as under:

"But section 11 comes under Part II of the Act, which deals with incorporation of companies and matters incidental thereto. The matters incidental thereto are that every company should have a memorandum of association and an articles of association. This Chapter also provides for certain other matters, namely, alteration of the memorandum of association or articles of association, the effect of failure to register such alteration, provisions with respect to names of companies, for change of registered office of companies, general provisions with respect to memorandum and articles, membership of companies, for reduction of number of members below legal minimum, provision for contracts and deeds, investments, seal, etc. Therefore, the provisions of section 11 must be understood in the context of Chapter II which deals with incorporation of companies and matters incidental thereto. Consequently, the prohibitions contained therein cannot be imported into Chapter X of the Act, which is a special chapter for the purpose of winding-up of unregistered companies. That is the reason the opening words of section 582 make it clear that "for the purpose of Part X", the expression "unregistered company" shall include any partnership, association or company consisting of more than seven members at the time when the petition for winding-up was presented before the court. Therefore, the word "association" has to be understood in its general senses and not with reference to the provisions contained in section 11 of the Act, prohibiting partnerships or associations consisting of more than 20 members from carrying on any business in matters more particularly mentioned in section 11(2) of the Act. Thus construed, there could be no bar to maintain this petition for the winding-up against an association like the respondents-association duly registered under the Societies Registration Act, as an unregistered company. Accordingly, the preliminary objection is overruled."

Section 4 of the Companies Act,1913 provided that no company, association or partnership consisting of more than ten persons shall be formed for the purposes of carrying on the business of banking unless it is registered."

Sub-section (2) stated as follows :

"No Company, association or partnership consisting of more than twenty persons shall be formed for the purpose of carrying on any other business" i.e. a business other than banking business "that has for its object the acquisition of gain by the Company, association or partnership, or by individual members thereof, unless it is registered as a Company under this Act or is formed in pursuance of an Act of Parliament of the United Kingdom or some other Indian Law or of Royal Charter or Letters Patent."

In the case of Raghubar Dayal Vs.Saraffa Chamber [AIR1954All555], in the context of Section 4 of Companies Act,1913, it was held by the Allahabad High Court that since the Saraff Chamber, an unregistered company, had more than 20 members, the same was illegitimately formed and cannot be wound up under the provisions of Part IX which dealt with winding up of unregistered companies. It was held by the court as under:

"By acceding to the petitioners' request to wind up the Company the Court will be indirectly according recognition to the Company. Since the law has forbidden the formation of such com- panies, it could never have been its intention to lend its helping hand to members who had formed this forbidden association. If such members are given the same rights and privileges as are provided, by law for persons who form associations permitted by law they suffer no penalty for having disregarded the express provisions of law regarding the formation of companies. I am, therefore, of the opinion that the Court should not entertain this petition for winding up of a company which was formed in contravention of Section 4(2) of the Indian Companies Act. I am, therefore, of the opinion that this petition must fail on the preliminary ground that the Court cannot entertain a petition for the winding up of a Company formed in contravention of the provisions of Section 4 of the Act."

Mewa Ram Vs.Ram Gopal [AIR1926All591] was also earlier decided by the Allahabad High Court on the above reasoning and did not allow the winding up unregistered company which violated Section 4(2) of the Companies Act,1913.

The case of K.N. Eswara Rao vs. K.H. Shama Rao and Sons, [2000(1)KarLJ589] is also relevant.

Therefore, an "Unregistered Company" formed with more than 50 or less than 7 members cannot be wound up under these provisions.

WINDING UP OF FOREIGN COMPANIES:

For the purpose of winding-up, foreign companies are also treated as unregistered companies. Section 376 provides that a body corporate incorporated outside India, which has been carrying business in India, ceases to carry on business in India, may be wound up as an unregistered company notwithstanding that the body corporate has been dissolved or otherwise ceased to exist as such under or by virtue of the laws of the country under which it was incorporated. All the provisions of the Companies Act with respect to winding-up shall apply to a foreign company.

In the case of Deutsche Dampschiffshrts Gessellschaft "Hansa" Bremen Vs. Bharat Aluminum Co. Ltd.[[1984]55CompCas727(Cal)], it has been held by the High Court of Calcutta that in the event it is found that the company has no assets whatsoever in India then final order of winding-up may not be passed, because the court will not exercise its powers in a jurisdiction which would be futile.

POWER OF THE TRIBUNAL TO WIND UP UNREGISTERED COMPANIES:

As per Section 375 of the Act, it is the National Company Law Tribunals established under Section 408 of the Companies Act, 2013, have the power to wind up of Unregistered Companies and it is the Official Liquidators who have to act as Liquidators for winding up of the Unregistered Companies.

CONCLUSION:

These provisions are rarely invoked since the jurisdiction of civil courts to dissolve the firms etc. is not barred. Though the objective behind inclusion of these provisions for winding up of firms, societies etc. is ideal, yet, in view of the fact that the respective Acts have elaborate mechanism to deal with the dissolution of these unregistered companies, Part II of Chapter XXI, except the provisions with regard to "Foreign Companies", should be deleted from the Companies Act, 2013 so that Companies Act exclusively and comprehensively deal with the Companies registered under the Companies Act, 2013.

The author may be reached at

Kshk.hareesh@gmail.com

Industry Focus - Auto Components Industry in India

Introduction

The Indian auto-components industry has experienced healthy growth over the last few years. The auto-components industry expanded 10.6 per cent to reach US$ 56.52 billion in FY19.

Auto-components industry account for 2.3 per cent of India's Gross Domestic Product (GDP) and employs as many as 1.5 million people directly and indirectly each. A stable government framework, increased purchasing power, large domestic market, and an ever-increasing development in infrastructure have made India a favourable destination for investment.

Market size

The industry can be broadly classified into organised and unorganised sectors. The organised sector caters to original equipment manufacturers (OEMs) and consist of high-value precision instruments while the unorganised sector comprises low-valued products and caters mostly to the aftermarket category.

Automobile component industry's revenue stood at US$ 56.52 billion in FY19, up from US$ 35 billion in FY14. As per Automobile Component Manufacturers Association (ACMA), automobile components export from India is expected to reach US$ 80 billion by 2026. The Indian auto components industry aims to achieve US$ 200 billion in revenue by 2026. Turnover of the industry stood at Rs 1.79 lakh crore (US$ 25.61 billion) in FY20 (till September 2019) and export of auto components grew 2.7 per cent to reach Rs 51,397 crore (US$ 7.35 billion) during the same time.

Investments

The Foreign Direct Investment (FDI) inflow into Indian automotive* industry during the period April 2000–March 2020 stood at US$ 24.21 billion as per the data released by Department for Promotion of Industry and Internal Trade (DPIIT).

Some of the recent investments made/planned in the Indian auto components sector is as follows:

- In February 2020, National Engineering Industries Ltd (NEIL) announced investment of Rs 100 crore (US$ 14.31 million) over the next three years for producing needle roller bearing at its Jaipur facility.
- In January 2020, Tata AutoComp Systems entered a joint venture (JV) with Beijing-based Prestolite Electric to enter the electric vehicle (EV) components market.
- In October 2019, Minda Industries acquired Germany-based automotive lamps firm Delvis Gmbh along with two of its subsidiaries for Rs 164 crore (US$ 23.47 million).
- In August 2019, Eaton partnered with Pune-headquartered technology firm KPIT.
- In April 2019, Durr, a German automotive painting and sealing company, entered a partnership with Patvin to provide automated painting solutions for two or three wheelers and agricultural machinery for the Indian markets.
- As of January 2019, Lite Auto Components Pvt Ltd, a part of Hindustan Magnesium Products Pvt Ltd, planned to invest Rs 500 crore (US$ 69.30 million) to set up Magnesium-based manufacturing plant in Andhra Pradesh.

Government Initiatives

The Government of India's Automotive Mission Plan (AMP) 2006–2016 has come a long way in ensuring growth for the sector. Indian Automobile industry is expected to achieve a turnover of US$ 300 billion by 2026 and will grow at a CAGR of 15 per cent from its current revenue of US$ 74 billion.

As per the Union Budget 2019-20, Government moved GST council to lower the GST rate on EVs from 12 per cent to 5 per cent. Also, to make EVs affordable to consumers, Government will provide additional income tax deduction of Rs 1.5 lakh (US$ 2,115) on the interest paid on loans taken to purchase EVs.

Government has come out with Automotive Mission Plan (AMP) 2016-26 which will help the automotive industry to grow and will benefit Indian economy in the following ways: -

- Contribution of auto industry in the country's GDP will rise to over 12 per cent.
- Around 65 million incremental number of direct and indirect jobs will be created.
- End of life Policy will be implemented for old vehicles

Achievements

Following are Government's achievements in the past four years:

- Production of two wheelers, passenger vehicles, commercial vehicles and three wheelers reached 21.03 million, 3.43 million, 0.75 million, and 1.13 million, respectively, in FY20.
- FAME – India Scheme formulated by Department of Heavy Industry, led to a continuous increase in registered OEMs and vehicle models. Also, the scheme enhanced the sales of EVs and about 261,507 electric/hybrid vehicles were supported under the scheme up to December 6, 2018. In February 2019, the Government approved FAME-II scheme with a fund requirement of Rs 10,000 crore (US$ 1.39 billion) for FY20-22.
- Under National Automotive Testing and research and development (R&D) Infrastructure Project (NATRiP), various facilities including passive safety labs comprising of crash core facility and crash instrumentations including dummies were established at ICAT-Manesar and ARAI-Pune.
- To give a fresh thrust to E-mobility in public transport, Department of Heavy Industry announced the launch of public and shared mobility based on electric powertrain.

Road Ahead

The rapidly globalising world is opening newer opportunities for the transportation industry, especially while it makes a shift towards electric, electronic and hybrid cars, which are deemed more efficient, safe, and reliable mode of transportation. Over the next decade, this will lead to newer verticals and opportunities for auto-component manufacturers, who would need to adapt change via systematic R&D.

As per ACMA forecasts, automobile component export from India is expected to reach US$ 80 billion by 2026.

The Indian auto-components industry is set to become the third largest in the world by 2025. Indian auto-component makers are well positioned to benefit from the globalisation of the sector as export potential could be increased by up to US$ 30 billion by 2021E

Note*:* Conversion rate used in April 2020, Rs 1 = US$ 0.013123

Note: * - Includes automobile and auto-components, E – Estimated, SAMARTH - Smart & Advanced Manufacturing and Rapid Transformation Hub

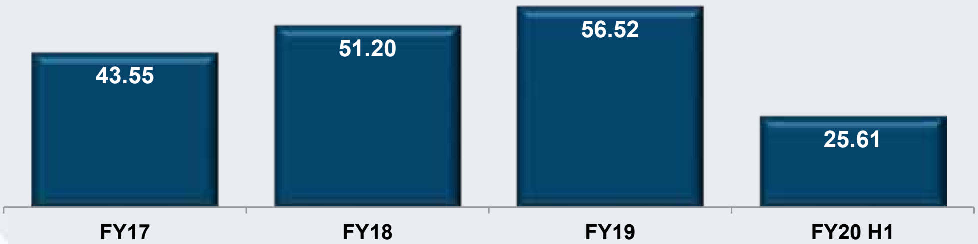
References

Media Reports, Press Releases, Press Information Bureau, IBEF, Ministry of Petroleum and Natural Gas, Confederation of Indian Industry's (CII) report

Auto Components

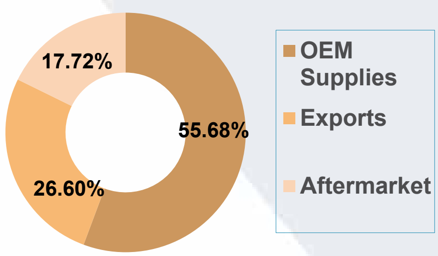
Market Size

Aggregate turnover (US$ billion)

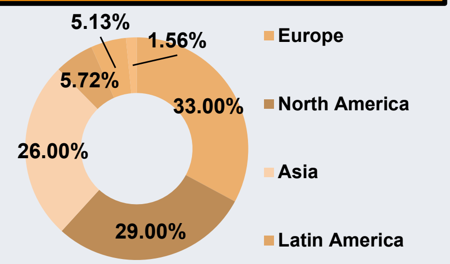


Sector Composition

Share in turnover of auto components industry (FY19)

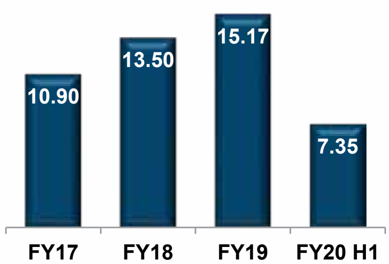


Shares in exports by geography (FY19)

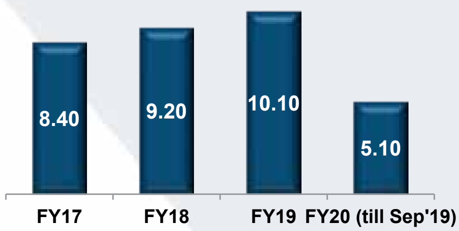


Key Trends

Value of auto component exports (US$ billion)



Value of aftermarket turnover (US$ billion)



Government Initiatives

NMEM

National Mission for Electric Mobility 2020

NATRiP
Driving India into the Future

NATRIP

Automotive Mission Plan 2026

INDUSTRY NEWS

* Air Asia's future in doubt due to virus; Share Price Tumbles

The future of top regional budget carrier Air Asia is in significant doubt after the collapse in travel demand caused by corona virus. Its auditor warned, resulting into tumbling of share price of the airline.

https://timesofindia.indiatimes.com/business/international-business/airasias-future-in-doubt-due-to-virus-share-price-tumbles/articleshow/76858464.cms

* NHAI to collaborate and partner with premier Technical Institutes for improving Highway Infrastructure leveraging local expertise

In its endeavor to provide world-class National Highways (NH) network, NHAI has approached all IITs, NITs and reputed Engineering Colleges to collaborate and adopt nearby stretches of NH, on voluntary basis, as part of Institutional Social Responsibility (ISR). The objective is to leverage the intellectual prudence of students and faculty towards improvement of road infrastructure ecosystem of the country. The Institutes along with its faculty and students have better appreciation of local requirement, topography, resource potential etc. and these vital inputs can be utilized by NHAI during different stages of pre-construction, construction, and operation of NH stretches. This decentralized approach, besides building a sense of participation in decision making, also provides an opportunity to the students for hands-on-learning, option for internship and future areas of research. The adoption of stretch by the Institute opens avenue for access to important data, which can be used to improve the quality and safety aspects of NH and enhance local capacity of the Institute in terms of advanced Lab and Simulation systems.

Adoption of NH stretch by an Institute would facilitate stakeholder engagement and help to mitigate the routine local problems such as traffic movement, congestion and immediate identification of accident-prone sites. The Highway users become more empowered in resolving local problems through the Institute and the Authority. Such instances would help NHAI in understanding the local needs both in present and future projects, improve the maintenance & riding comfort and develop wayside amenities for enhanced user experience. The overall outcome shall be commuter friendly and enjoyable ride on the NH stretch.

Large numbers of IITs, NITs and Engineering Colleges have opted to join the scheme and NHAI officers have started mutual consultation with Directors of the interested Institutes. Memorandums of Understanding (MOU) are being signed between the individual Institutes and NHAI for institutionalization of the scheme and bring reformative improvements in the road infrastructure of the country.

* SEBI (Substantial Acquisition of Shares and Takeovers) (Third Amendment) Regulations, 2020

SEBI further amended the provisions with respect to the escrow account in case of indirect acquisition towards the consideration payable under the open offer. SEBI further laid down other procedure in case, where the acquirer is unable to make payment to the shareholders who have accepted open offer within given time period.

(For more details, please click on: https://www.sebi.gov.in/legal/regulations/jul-2020/securities-and-exchange-board-of-india-substantial-acquisition-of-shares-and-takeovers-third-amendment-regulations-2020_46990.html) References: Compilation from various reports such as Business Standard, IBEF and other media

* Credit flow to Micro, Small and Medium Enterprises Sector

After change in criteria of classification of MSME by the Government of India, vide Gazette Notification S.O. 2119 (E) dated June 26, 2020, the Reserve Bank of India has also issued a notification to initiate necessary action for reclassification of enterprises as per the new definition w.e.f. July 1, 2020 and issued necessary instructions to all Commercial Banks/FIs/NBFCs/UCBs/SCBs for their branches/controlling offices in this regard, at the earliest.

https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11934&Mode=0

* Valuing Valuers: Four recommendations that may standardise valuation practices

The government constituted a committee of experts to examine the need for a comprehensive framework for regulation and development of valuation professionals in India. The Committee submitted its recommendations in April 2020 and proposed the Draft Valuers Bill, 2020 ('Bill'). The primary objectives of the proposed framework are the development and regulation of the valuation profession and a market for valuation services, and protection of interest of users of valuation services. The four recommendations focused upon the following key points: Regulatory Architecture; Development; Regulation and Regulating the market for valuation services.

https://www.financialexpress.com/opinion/valuing-valuers-four-recommendations-that-may-standardise-

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valuation-practices/1957012/

* Are Fair Values appropriately determined?

The COVID-19 pandemic has significantly affected financial markets in the first quarter of 2020. Stock markets have declined sharply and volatility has increased. Treasury bond yields have reached record lows and credit-default-swap indices have been surging while reflecting concerns of increased corporate defaults. For several assets and liabilities, fair values may have changed significantly, reflecting changes in cash flow forecasts, higher uncertainty and increased risks.

https://home.kpmg/xx/en/home/insights/2020/03/covid-19-assets-1b.html

* Flipkart invests Rs 260 crore in Arvind Youth Brands

Flipkart Group bought a minority stake in Arvind Youth Brands, a subsidiary of Arvind Fashions Ltd's (AFL), for Rs 260 crore (US$ 36.88 million). The company, which owns denim brand Flying Machine, plans to build the brand online and in India's smaller markets.

Flying Machine is a four-decade old brand and has been selling on Walmart-backed Flipkart and Myntra for over six years. "Through this investment, the Flipkart Group and Arvind Fashions will work collaboratively to identify opportunities and synergies to innovate and develop products with strong value propositions at attractive price points," as per the Arvind Fashions Ltd filing to the exchanges.

Arvind Fashions oversees international and local fashion apparel brands in the country such as US Polo Assn., Arrow, GAP, Tommy Hilfiger, Flying Machine, Aeropostale, The Children's Place and Ed Hardy. It also operates the value fashion retail chain, Unlimited, apart from a partnership with beauty retailer Sephora for its India business. The company has been trying to reduce its dependence on physical stores. With this move, it is moving online for its business.

"The partnership with the Flipkart Group will help us accelerate our online growth strategy as we focus our efforts on developing an omni-channel retail approach for Arvind Youth Brands and Flying Machine," said Mr J. Suresh, managing director and chief executive officer, Arvind Fashions. Mr. Suresh added that Flipkart and Myntra will be the brand's preferred online partners, even as it continues to grow offline sales through channels like exclusive brand stores, department stores and multi-brand stores.

Flipkart will leverage the brand's popularity that has over the years moved to India's smaller cities and expand its presence on its platform with value price points for shoppers in that segment. "Through this investment, we look forward to partnering with the team at Arvind Youth Brands to continue to grow the market for its portfolio of products and enhance the strong brand equity that has been built over the last few decades, " said Mr Kalyan Krishnamurthy, Chief Executive Officer, Flipkart Group.

In another filing to the exchanges, Arvind Fashions Ltd., said the company and its wholly owned subsidiary, Arvind Lifestyle Brands Limited, have each signed definitive agreements to transfer the wholesale trading and the retail trading business in "Flying Machine" brand to a wholly owned subsidiary, Arvind Youth Brands Private Limited. In FY19, Flying Machine brand, under Arvind Fashions Ltd., recorded a standalone turnover of Rs 365 crore (US$ 51.78 million).

Flipkart has been gradually growing its presence in India's fashion apparel market. Fashion retailer Myntra, part of the Flipkart Group, won the rights in 2017 to manage Spanish fashion brand Mango's offline stores in India, as well as sell the brand exclusively on its online marketplace.

* SEBI signs MOU with CBDT

A Memorandum of Understanding (MoU) is signed between SEBI and CBDT (Central Board of Direct Taxes) to facilitate the data exchange between the two organizations. The MoU will facilitate the sharing of data and information between CBDT and SEBI on an automatic and regular basis. In addition to regular exchange of data, CBDT and SEBI will also exchange with each other, on request and *suo moto* basis, any information available in their databases, for the purpose of carrying out scrutiny, inspection, investigation and prosecution.

https://www.sebi.gov.in/media/press-releases/jul-2020/sebi-signs-mou-with-cbdt_47030.html

* Apple supplier Foxconn plans to invest US$ 1 billion in India: Sources

Foxconn plans to invest up to US$ 1 billion to expand a factory in southern India where the Taiwanese contract manufacturer assembles Apple iPhones. This is can be considered as a move by the company to shift its base because of the disruptions from a trade war between Beijing and Washington and the coronavirus crisis.

"There's a strong request from Apple to its clients to move part of the iPhone production out of China," according to one of the sources with direct knowledge of the matter. Though, there was no official statement by

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Foxconn or Apple regarding the matters. The investment is planned over the course of next three years in the Sriperumbur plant, where Apple's iPhone XR is made some 50 km west of Chennai. It is expected to manufacture other iPhones models at the plant.

Foxconn is headquartered in Taipei and will add some 6,000 jobs at the Sriperumbur plant in Tamil Nadu state under the plan. The company also operates a separate plant in the southern Indian state of Andhra Pradesh, where it makes smartphones for China's Xiaomi Corp, among others. Last month, Foxconn Chairman Mr. Liu Young-way has said it would ramp up its investment in India, without giving details.

In India, the world's second-biggest smartphone market, Apple holds about 1 per cent of smartphone sales here. iPhones is status symbol in India because of its pricey nature.

This move is also expected to help Apple save on import taxes that further push up its prices. Apple assembles a few models through Taiwan's Wistron Corp in the southern tech hub of Bengaluru. Wistron is also set to open a new plant, where it plans to make more Apple devices. "With India's labour cheaper compared with China, and the gradual expansion of its supplier base here, Apple will be able to use the country as an export hub," Mr Neil Shah of Hong Kong-based tech researcher Counterpoint said.

The government of India has been working to boost electronics manufacturing by firms such as Foxconn and launched a US$ 6.65 billion plan last month, offering five global smartphone makers incentives to establish or expand domestic production. This is move of manufacturing locally is expected to be a boost for Prime Minister Narendra Modi's flagship "Make in India" drive, aimed at creating new jobs.

* Cyber insurance: still at an emerging stage in India

India ranks 3rd amongst top 20 countries that are victims of cybercrimes, according to the Internet Crime Report for 2019, released by FBI's Internet Crime Complaint Centre. According to ICICI Lombard General Insurance, hackers based in China attempted over 40,300 cyber attacks on India in the third week of June, mostly Covid-19 based scams. Even as the cyber security threat growing large in India, cyber insurance covers have not picked up in a big way. While the non-life insurance industry received premiums of Rs 1.89 lakh crore in the last financial year, the share of cyber insurance was a paltry Rs 200-220 crore.

https://www.financialexpress.com/money/insurance/cyber-insurance-still-at-a-nascent-stage-in-india-email-spoofing-phishing-attacks-icici-lombard-general-insurance-bharti-axa-general-insurance/2011732/

* Merger halted of the Three Major Insurance Companies

The Union Cabinet on July 08, 2020 decided to halt the merger process of three state-owned general insurance companies, National Insurance, Oriental Insurance and United India Insurance, for the moment and approved fund infusion of Rs 12,450 crore to improve their financial health. It was also decided to increase the authorised share capital of National Insurance Company Limited (NICL) to Rs 7,500 crore and that of United India Insurance Company Limited (UIICL) and Oriental Insurance Company Limited (OICL) to Rs 5,000 crore each to give effect to the capital infusion decision.

https://www.financialexpress.com/money/insurance/national-insurance-oriental-insurance-united-insurance-merger-halted-by-modi-govt/2017829/

* The Food Safety and Standards Authority of India has issued Standard Operating Procedures for reactivation of rejected applications and change in a user profile including new login credentials, Email id etc.

The Food Business Operators shall apply to concerned regional officers of FSSAI for reactivation of license application within 6 months from the date of rejection and the application may be rejected automatically by the system due to non-furnishing of information/documents by FBO within 30 days. The FBOs intending to change their user profile shall submit a representation in this regard to the Joint Director, Regulatory Compliance Division. The application should be on the letterhead of the firm/company duly signed by the authorized person and a copy of photo identity card and a copy of an existing license shall be enclosed along with the application. In case, FBOs want new login credential, they have to create a new login ID and Password and the same would be indicated in their application so that the IT team can validate and map the licenses or registrations in new login credentials.

https://fssai.gov.in/upload/advisories/2020/07/5f0431c7922e6Letter_SOP_Reactivation_Rejected_Applications_07_07_2020.pdf

References: Compilation from various secondary sources and reports such as Business Standard, PIB, ICSI, IBEF and other media

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

(Statutory body under an Act of Parliament)

www.icmai.in

Headquarters

CMA Bhawan, 12 Sudder Street, Kolkata - 700016

Ph: +91-33-2252 1031/34/35/1602/1492

Delhi Office

CMA Bhawan, 3 Institutional Area, Lodhi Road, New Delhi - 110003

Ph: +91-11-24666100

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