



## Corporate Governance Under the Companies ACT 2013: A More Responsive System of Governance

### KEYWORDS

Independent Director, CSR, Class Action, Committees.

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**ABSTRACT** *This paper is a legislative comment and analysis of the role of corporate governance under the Companies Act 2013. Today companies are expanding globally and hence company's responsibilities and duties towards itself and its stakeholders has increased and so has the need for a good governance mechanism. With an effective internal management the companies can ensure fair practises, shareholders trust and stakeholders stability. The Companies Act 2013 is considered to be phenomena as it has introduced important and ignored aspects of corporate governance in a practical as well as stringent manner. Be it the role and accountability of directors or the establishment of internal as well as external committees, the legislation has explored in detail each and every component of corporate governance. The 2013 Act has also introduced certain provisions to facilitate adequate governance. This paper seeks to discuss these provisions and its implications on companies and its members.*

### INTRODUCTION

Governance is a mechanism followed by organisations to ensure that their policies and procedures are implemented and followed effectively. It is the most efficient way to control the actions of the organisation. The term Corporate Governance was introduced in the year 2002 by The Sarbanes Oxley Act in the U.S after the accounting fraud of high profile companies, Enron and WorldCom. Rules, practices and processes are the three important components which constitutes corporate governance and by which a company is directed and controlled. A company consists of many stakeholders. These stakeholders include the investors, consumers, shareholders, management, suppliers, government and the community who play a very vital role in a company. Corporate Governance strives to balance the interest of the company with its stakeholders.

An effective Corporate Governance involves strategies to monitor and record the activities of a company, to ensure the implementation and compliance of policies and procedures, and to take strict actions in cases of non-compliance or ignorance of these policies and procedures. The need for Corporate Governance was dearly felt after the infamous scams that hit India in the ninety's. These scams majorly refer to Harshad Mehta and Ketan Parekh in the year 1992 and 1999 respectively. These names had a negative impact in the field of Stock Market and brought forward the drawbacks and ineffectiveness of the regulatory authorities governing trading in India. Even after several amendments and changes in the system, the recent Satyam Scam yet again proved flaws in the governance system. Therefore, the concept of Corporate Governance holds high importance in the corporate field today.

Corporate Governance is necessary to ensure compliances of policies and procedures that are required to be followed by the companies in their daily course of business activities. Transparency and accountability is what the stakeholders and shareholders expect from the directors of the company. Hence, it is essential to understand the legal aspects through legislations like Companies Act which lays down the certain conditions and mannerism that companies are required to comply with in order to ensure effective corporate governance.

#### 1. Directors

The Act has inserted certain provisions conferring responsibilities on the directors of the company. They are as follows:

- a. A person can be a director for a maximum of 20 companies. However, only 10 can be a public company out of 20.
- b. A public as well as a private company can have a maximum of 15 directors. Any further increase in the number of directors can be done by passing a Special Resolution in the General Meeting.
- c. Prescribed class of companies are required to have a minimum of one woman director on the board.
- d. The Act makes it mandatory for a company to have minimum one director who has stayed in the country for a period of 182 days in the previous calendar year.
- e. The Act requires listed companies to have one director appointed by small shareholders.
- f. Under the Act, a director needs to send a copy along with the reason for resignation within 30 days to the ROC.
- g. The Act mentions additional reports such as extract of Annual Return, number of board meetings, CSR initiatives and policies, particulars of loans, guarantees, investments etc.

The 1956 Act allowed a person to be a director for a maximum of 20 companies which was amended in 2000 and the number was brought down to 15 companies. However, under the present Act a person can be a director for a maximum of 20 companies. The increase in the number of directorship of the companies has thereby increased the responsibility of the directors in the company. The director's accountability and transparency has also increased as they are required to submit various other important reports during the board meetings in order to ensure effective compliances of the policies.

#### 2. Independent Directors

The concept of Independent Directors is introduced for the first time under this Act. Independent directors are a part of the board of directors but they do not have any pecuniary interest in the company but take part in the board meetings and are rewarded sitting fees. They do not hold shares in the company. The Act provides for the following provisions with respect to Independent directors:

- a. Every listed company should have at least one-third of its total number of directors as independent directors.
- b. The Act provides the Central Government power to prescribe minimum number of independent directors in other class of public companies.
- c. The Act defines "independent director" in same way as given under the listing agreement but lays down few ad-

ditional qualification and traits and the kind of relationship that they are expected to share with the company and its members.

- d. The independent director is required to give the status of his independence whenever required.
- e. The Act provides for the selection of independent director from a data bank maintained by an association, body or institute or as per the specification of the Central government.
- f. The independent director is not entitled to any stock options in the company.

Since an independent director does not hold any pecuniary interest in the company, the decisions will be taken without any prejudice. Moreover, the Act lays down code of conduct that an independent director needs to follow. The "code for independent directors" is a detailed guideline for professional conduct, roles and responsibilities. The Act holds an independent director liable for only those acts omitted or committed with his knowledge, consent or connivance etc.

### 3. Corporate Social Responsibility

Corporate Social Responsibility is an emerging concept in the corporate world. The Act requires for every company having a net worth of Rs. 500 crore or more, or a net profit of Rs. 500 crore or more during any financial year, or a turnover of Rs. 1000 crore or more to constitute a CSR committee. The other key highlights of CSR for a company are as follows:

- a. The Act requires the CSR committee to constitute three or more directors out of which one director has to be an independent director.
- b. The CSR committee will directly report to the board and will formulate, recommend, monitor various CSR policies and submit the same to the board along with a budget allocated for CSR activities.
- c. The board has to ensure that the company spends in every year at least 2% of its average net profits made during the three immediately preceding financial year towards CSR.
- d. To begin with, companies are required to start the CSR activities in the local area and the place where it is situated.
- e. The board carries the responsibility of approving CSR policies and submit the same in the board report along with its publication on the company's website. If the board does not comply with spending the fixed mandatory amount for CSR, it has to give the reasons in the report.
- f. Lastly, Schedule VII of the Act specifies certain activities that need to be taken as major CSR activities by the companies. These activities include: eradicating extreme hunger and poverty, promotion of education, promoting gender equality and empowering women, reducing child mortality and improving maternal health, combating HIV aids, malaria and other diseases, ensuring environmental sustainability, employment enhancing vocational skills, social business projects and contribution to certain funds and other matters.

Business transactions take place on day to day basis and their profit is reserved for shareholders, employees and management. We can notice how the companies have ignored the most important factor of business environment, the society. Where on one hand the Act makes CSR a mandatory provisions, on the other hand it fails to penalise the companies for non-compliance. Also, the treatment of CSR expenses for the purpose of taxation needs to be more simplified. However, this provision opens a forum for debate.

### 4. Serious Fraud Investigation Office

The Act provides statutory status to SFIO. The Central Government holds authority to designate SFIO to conduct investigation in case of any issues in the company's affair. The investigation would begin for matters effecting public interest, any report being filed by the registrar or inspector, any

intimination being made by the company wanting to conduct an investigation in the company affairs by way of special resolution or an investigation to be done on request of Central or State government.

Granting of statutory status to SFIO in a company is a vital achievement. The SFIO holds power equivalent to that of the police officer. Since there are no stringent rules to punish the wrongdoer in the company, it's here where SFIO will play a major role in investigating and reaching to the roots of the fraud so committed and will also help to take appropriate action against the commission of such crimes.

### 5. Class Action

Section 245 of the Act contains provisions protecting the interest of shareholders by introducing class action proceeding. These provisions explicitly enable the depositors or the members to file a class action suit whenever the rights are infringed. They have a benefit of forming a group if the matter is of common interest and precede the suit thereafter. A suit can be filed against the directors, defaulting company, officers, experts, auditors and partners of the audit firms. The members and depositors can now claim for compensation and damages when their interests are not protected. The earlier Act did not provide for such a remedy to the members and depositors of the company. These provisions are certainly beneficial to protect the interest of the shareholders and depositors in cases where their rights are violated or where the company or the management has caused any sort of loss to them.

### 6. Audit Committee

The Act provides for the set up of audit committees for listed companies and such other class of companies. The Act lays down following provisions with respect to audit committees:

- a. The audit committee should comprise minimum of three directors with majority of independent directors.
- b. The audit committee members and the chairman should be able to read and understand the financial statements of the company.
- c. The Act provides for an establishment of vigilance mechanism for directors and employees of listed companies and such other class of companies.
- d. Any default or non compliance of these requirements will result to fine which may extend up to Rs. 5 lakh.

An audit committee will provide better financial governance. Their main responsibility will be to cross check the financial statements and maintain its accuracy without any fraud. The audit committee is vested upon with certain responsibilities which they have to adhere to and ensure effective functioning. The recent Satyam Scam showed failure on part of the auditors who were negligent in checking the books of accounts and finding out the financial fraud done by the directors of the company. Therefore, insertion of audit committee will guarantee better transparency and accuracy in the financial statements.

### 7. Internal Audit

The Act provides companies of certain class as may be prescribed to appoint an internal auditor to carry on internal auditing on the functions and activities of the company. The board should either appoint chartered accountant or cost accountant or any other professional for the purpose of carrying internal audit. The Central government has the authority to decide the manner and the time period in which the audit will be conducted and the structure of reporting the same to the board.

Internal audit for companies will ensure accuracy in the books of accounts of the companies free from misappropriation. An appointment of internal auditor will definitely increase the level of transparency which in turn will help in creating as well as maintaining a better relationship between the company and its stakeholders.

### 8. Nomination and Remuneration Committee

The Act mandates all the listed companies to set up a Nomination and Remuneration Committee which will consist of three or more non-executive directors out of which not less than one half should be independent directors. The NRC is bestowed upon with the responsibility to identify and nominate persons who are qualified to become directors or hold a management position in the company in accordance with the criteria laid down. Apart from this the NRC has the responsibility to evaluate the performance of the directors. The NRC shall also formulate the remuneration policies for directors and present the same before the board. The formation of such committees ensures fair nomination and remuneration of the directors. But publication and public availability of policy of remuneration fails to maintain financial privacy of directors and the management. Nevertheless, apart from this drawback, the committee holds many positives as discussed above.

### 9. Stakeholders Relationship Committee

A company having more than 1000 shareholders, debenture-holders, deposit holders or any other security holder should set up a Shareholders Relationship Committee. The chairperson of SRC should be a non-executive director. This is a unique committee as it explicitly deals with the grievances of the security holders of the company. There are more than thousands of security holders in a company and each of them might have certain problems and issues which will be resolved by this committee thereby building up a strong relationship between the security holders and the company.

### CONCLUSION

Corporate Governance is composed of three core ingredient i.e. accountability, transparency and responsibility which is essential for every company. Directors play a very significant role in a company. They are the managers of the company

affairs and hold the responsibility to maintain a fair balance between the company and its members. This can be done effectively only through a good governance system. There were several committees set up in the country in last decade which recommended provisions relating to corporate governance. The Kumar Mangalam Birla Committee, Narayan Murthy Committee, J.J. Irani Committee etc. The current Companies Act 2013 has to an extent incorporated several recommendations made by J.J. Irani Committee.

The Companies Act 2013 is a remarkable achievement in the history of Company Law. As analysed above, many provisions relating to good corporate governance has been incorporated and the companies along with its members have no other option than to follow them and ensure effective governance. The term Independent Directors was introduced for the first time and has been incorporated in the Act. Moreover, the concept of Corporate Social Responsibility holds a vital position in the Act. Since there were lacunas in the previous Act with respect to corporate governance, the new Act provides for a better mechanism of governance ensuring a transparency between the company and those related to the company. Thus, with the incorporation of new provisions in the Act in relation to corporate governance the stakeholders can expect better accountability, transparency and responsibility from the Board and the company.

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