

Corporate Governance

The Companies Act, 2013 provides a formal structure for corporate governance by enhancing disclosures, reporting and transparency through enhanced as well as new compliance norms.

Apart from this,

- The Monopolies and Restrictive Trade Practices Act, 1969 (which is replaced by the Competition Act 2002),
- The Foreign Exchange Regulation Act, 1973 (which has now been replaced by Foreign Exchange Management Act, 1999),
- Desirable Corporate Governance Code **by the Confederation of Indian Industries (CII) in 2009.**
- The issue of corporate governance for listed companies came into prominence with the report of the Kumar Mangalam Birla Committee (2000) set up by SEBI in the to suggest inclusion of a new clause, Clause 49 in the Listing Agreement to promote good corporate governance.
- **Naresh Chandra Committee(2002)** to examine various corporate governance issues primarily around auditor – company relationship, rotation of auditors and defining Independent directors.
- **Narayana Murthy Committee (2003)** by SEBI, which provided recommendations on issues such as audit committee's responsibilities, audit reports, independent directors, related parties, risk management, independent directors, director compensation, codes of conduct and financial disclosures. Many of these recommendations were then incorporated in the Revised Clause 49 that is seen as an important statutory requirement. Further, after enactment of the Companies Act, 2013, SEBI has amended Clause 49 in 2013 to bring it in line with the new Act.

Recommendations and suggestions of various committees are considered and incorporated or amended relevant rules and regulations to ensure corporate governance-

Board of Directors

The Desirable Corporate Governance Code by CII (1998) for the first time introduced the concept of independent directors for listed companies and compensation paid to them.

The Kumar Mangalam Birla Committee (2000) then suggested that for a company with an executive Chairman, at least half of the board should be independent directors, else at least one-third.

The updated Clause 49 based on the report by the Narayana Murthy Committee further elaborates the definition of Independent Directors; and also requires listed companies to have an optimum combination of executive and non-executive directors, with non-executive directors comprising of at least 50% of the Board.

The 2013 Act introduces the requirement of appointing a resident director and a woman director. The term ‘Key Managerial Personnel’ has been defined in the 2013 Act, comprising of Chief Executive Officer, Managing director, Manager, Company Secretary, Whole-time director, Chief Financial Officer; and any such other officer as may be prescribed.

The 2013 Act has also introduced new concepts such as performance evaluation of the board, committee and individual directors. The revised Clause 49 (in 2013) now also states that all compensation paid to non –executive directors, including independent directors shall be fixed by the Board and shall require prior approval of shareholders in the General meeting and that limit shall be placed on stock options granted to non executive directors. Such remuneration and stock option is required to be disclosed in the annual report of the company. The independent directors are also required to adhere to a ‘Code of Conduct’ and affirm compliance to the same annually.

Audit Committee

As per section 177 of the Companies Act, 2013 read with Rule 6 of Companies (Meetings of Board and its powers) Rules, 2014, every listed company and all other public companies with paid up capital of Rs. 10 crore or more; or having turnover of 100 crore or more; or having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding Rs.50 Crores

or more, to have an Audit Committee which shall consist of not less than three directors and such number of other directors as the Board may determine of which two thirds of the total number of members shall be directors, other than managing or whole-time directors.

The Kumar Mangalam Birla Committee, Naresh Chandra Committee and the Narayana Murthy Committee recommended constitution, composition for audit committee to include independent directors and also formulated the responsibilities, powers and functions of the Audit Committee. The Audit Committee and its Chairman are also entrusted with the ethics and compliance mechanisms of an organization, including review of functioning of the whistleblower mechanism.

The revised Clause 49 expands the role of the Audit Committee with enhancing its responsibilities in providing transparency and accuracy of financial reporting and disclosures, robustness of the systems of internal audit and internal controls, oversight of the company's risk management policies and programs, effectiveness of anti-fraud and vigil mechanisms and review and administration of related party transactions of the organization.

Subsidiary Companies

The rationale behind having separate provisions with respect to subsidiary companies in the Revised Clause 49 was the need for the board of the holding company to have some independent link with the board of the subsidiary and provide necessary oversight.

Hence, the recommendation of Narayana Murthy Committee to make provisions relating to the composition of the Board of Directors of the holding company to be made applicable to the composition of the Board of Directors of subsidiary companies and to have at least one independent director on the Board of Directors of the holding company on the Board of Directors of the subsidiary company, were incorporated in the Revised Clause 49 of the Listing Agreement.

Role of Institutional Investors

If a company wants institutional investor participation, it will have to convincingly raise the quality of corporate governance practices. Indian companies thus need to adopt the best practices such as the OECD Corporate Governance Principles (revised in 2004) that serve as a global benchmark. In countries like India where corporate ownership still continues to be

highly concentrated, it is important that all shareholders including domestic and foreign institutional investors are treated equitably.

Institutional investors are expected to actively participate in the AGM voting on the shares held by them in their portfolio companies along with public disclosure of their voting records and reasons for non-disclosures. Their reason for assenting or dissenting to any Board Resolution of their portfolio companies shall be disclosed on their website.

Stakeholders Relationship Committee

As one of its mandatory recommendations, the Kumar Mangalam Birla Committee propounded the need to form a board committee under the chairmanship of a non-executive director to specifically look into the redressing of shareholder complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc. The Committee believed that the formation of shareholders' grievance committee would help focus the attention of the company on shareholders' grievances and sensitise the management to redress their grievances.

The 2013 Act as well as the revised Clause 49 now mandate the formation of such a committee with broader remit to cover issues and concerns of all stakeholders and not just shareholders.

The 2013 Act now mandates companies with more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year are required to constitute a Stakeholders Relationship Committee consisting of a chairperson who shall be a non-executive director and such other members as may be decided by the Board to resolve the grievances of security holders of the company.

Risk Management

Risk Management was however propounded for the first time by the Narayana Murthy Committee (2003). The Kumar Mangalam Birla Committee report included mandatory Management Discussion & Analysis segment of annual report that includes discussion of industry structure and development, opportunities, threats, outlook, risks etc. as well as financial and operational performance and managerial developments in Human Resource /Industrial Relations front.

The 2013 Act and Revised Clause 49 specify requirements related to risk management. Audit Committee and the independent directors of the company are entrusted with the responsibility of evaluating the robustness of the risk management systems and policy laid down by the Board.

Ethics

The Naresh Chandra Committee for the first time recommended that companies should have an internal code of conduct. The Report by Narayana Murthy Committee further recommended that a company should have a mechanism (whistle blower) to report on any unethical or improper practice or violation of code of conduct observed and that Audit Committee would be entrusted with the role of reviewing functioning of the mechanism.

Clause 49 incorporated these recommendations further mandating directors of every listed company to lay down a Code of Conduct and post the code on their company's website

Executive Remuneration

The 2013 Act and Revised Clause 49 mandate the formation of a Nomination & Remuneration Committee comprising of at least three directors, all of whom shall be non-executive directors and at least half shall be independent. The Nomination and Remuneration Committee is to ensure that the level and composition of remuneration is reasonable and sufficient

Directors' Responsibility Statement

To promote better disclosures and transparency, the 2013 Act, requires the company's Annual Report to include a Director's Responsibility Statement stating the following:

- (a) Applicable accounting standards had been followed in the preparation of the annual accounts
- (b) The directors have selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company
- (c) Proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities

(d) The annual accounts of the company are prepared on a going concern basis

(e) The directors have laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively

(f) The directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.

CEO/CFO Certification

The Naresh Chandra Committee for the first time required the signing officers, to declare that they are responsible for establishing and maintaining internal controls.

The 2013 Act and revised Clause 49 have also brought much rigour into internal controls certification by making it as one of the parts of Directors' Responsibility Statement.

Internal control is a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Regulators

- Securities Exchange Board of India (SEBI)
- Ministry of Corporate Affairs (MCA)

Laws, Regulations and Reports

- Report of the Committee on Corporate Governance for public comments
- Integrated Reporting by Listed Entities
- Securities and Exchange Board of India guidelines on Board Evaluations
- Securities and Exchange Board of India (Listing Obligations And Disclosure Requirements) (Amendment) Regulations, 2017
- Report of The Companies Law Committee

- Principles of Corporate Governance (G20 2015, OECD)
- Bajjal Committee report
- The Companies Act of 1956
- The Companies Act of 2013
- The Desirable Corporate Governance - a code
- The Naresh Chandra Committee Report
- The Kumar Mangalam Birla Committee Report
- The N R Narayana Murthy Committee Report
- Clause 49 of the Listing Agreement
- Revised Clause 49 of the Listing Agreement

Statutory Bodies

- Institute of Company Secretaries of India (ICSI)
- ICAI

Others

- National Foundation for Corporate Governance (NFCG)
- Corporate Governance section from the Business Portal of India
- The Competition Commission of India
- The Central Vigilance Commission of India
- Confederation of Indian Industries (CII)
- Institute of Internal Auditors (IIA) India
- Bombay Chartered Accountants Society (BCAS)
- Asian Corporate Governance Association (ACGA)
- Information Systems Audit and Control Association (ISACA)