



# ROLE OF INDEPENDENT DIRECTORS IN CORPORATE GOVERNANCE

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**PROLE OF INDEPENDENT DIRECTORS IN  
CORPORATE GOVERNANCE**

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## Preface

The concept of Independent Directors have gained a worldwide momentum in the wake of Corporate Governance in recent years with the advent of various corporate failures such as Satyam Debacle, Enron Debacle, and several other scandals. Corporate Experts have always felt the need for the directors to be independent and free from the influence of the Board. Independent Directors have a key role in the entire mosaic of corporate governance. It is increasingly being recognized that independent directors occupy a pivotal position with respect to the progress of the company. In fact Independent Directors are considered as both a safeguard and a significant source of competitive advantage.

So, the phrase independent director is not an oxymoron. It is just a difficult service to shareholders that is still evolving. Independent directors with good business sense, strength of character, dedication and positive attitude are playing a major role in improving corporate governance. Fortunately, investors are recognising the importance of such independent directors and superior corporate governance in companies and are rewarding such companies with a governance premium. Having strong independent directors is good for all shareholders, including promoters.

This book is written in simple language explaining the role of independent director in corporate governance with reference to the Companies Act, 2013 and best practices followed. This book is useful for board of directors, company secretary, independent director, regulators, academicians, auditors and person who wants to be an independent director.



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## 1. INTRODUCTION

The English word *company* has its origins in the Old French military term *compaignie* (first recorded in 1150), meaning a “body of soldiers”, originally taken from the Late Latin word *companiono* “companion, one who eats bread with you”, first attested in the Lex Salica as a calque of the Germanic expression \**gahlaibo* (literally, “with bread”), related to Old High German *galeipo* “companion” and Gothic *gahlaiba* “messmate”. By 1303, the word referred to trade guilds. Usage of company to mean “business association” was first recorded in 1553 and the abbreviation “co.” dates from 1769.

There are various forms of business organisations for doing business like Sole Proprietorship, Partnership, Limited Liability Partnership, company etc. The company with its attributes such as separate legal entity, perpetual succession, common seal etc. has made it the most preferred mode to carry on giant business ventures. The significance of companies in everyday life has increased to such a great extent that every country has a bundle of legislations specifically regulating them.

The Directors form a vital organ of the company. Even though the company has its own legal existence, they can act only through human beings. The role of the director in a company is similar to the role of the brain in the human body as they deal with the operation and management of the company. The Directors act as managers, trustees, agents etc. for the corporate body. The basic principles of agency govern the relations of the Directors with the company and of the person dealing with the company through its Directors. The Director steps into the shoes of the trustee while dealing with the company’s funds and property.

Broadly, there are three types of directors.

- Full time, executive director who is normally a paid employee of a company having some functional responsibility.
- Non-executive but non independent director who is normally a promoter of the company or having high stakes in the company.
- And finally independent directors who are not full time directors. There is another class of directors known as nominee directors representing some interests like lending institutions etc.

An executive director, by very nature has much more responsibilities than non executive directors. In law it is their responsibility to ensure compliance with provisions of law failing which they could

be held liable as officers in default. As far as independent directors are concerned, their role is to contribute to the development of the corporate strategy and to review the performance of the management in meeting the agreed goals and objectives, with their wide experience and fresh perspectives and also to add value to the company in various other areas through their knowledge.

### 1.1. Snapshot of Directors of Indian Listed Companies

- ✓ 9,698 individuals are on the boards of 1,492 NSE-listed companies.
- ✓ These 9,698 individuals occupy a total of 13,663 directorship positions in 1,492 companies listed at NSE and 1,294 companies listed on BSE.
- ✓ Of these 9,698 individuals -
  - 7,411 hold only 1 directorship each in companies listed on NSE & BSE.
  - 4,373 hold only independent directorship positions in NSE listed companies.
  - Only 1,301 are women (13.42%), occupying a total of 1,752 directorships. There is atleast one woman on the board of 1,401 NSE listed companies.
  - 307 individuals holding 351 directorship positions in NSE listed companies are foreign nationals.
  - 225 individuals hold 5 or more than 5 directorships in companies listed on NSE & BSE.
  - 349 individuals are from Civil services, occupying a total of 570 directorships in NSE listed companies.
- ✓ Of 1,492 companies, 585 have a non-executive chairman, of which 269 companies have Promoter-Directors as Non-Executive chairman.
- ✓ The average age of directors is 59 years.
- ✓ The youngest director is aged around 23 years and the oldest is around 96 years.
- ✓ 11 individuals are below the age of 25 and 1,502 individuals are above 70 years.

- ✓ 47.74% of directorship positions are held by post-graduates.
- ✓ 1,948 (20.09%) are Chartered Accountants, 177 (1.83%) are Company Secretaries and 39 (0.40%) are Cost Accountants.
- ✓ 530 (5.47%) are lawyers.
- ✓ 76 are medical doctors.
- ✓ 1,757 are engineers.

*(The above information is based on all NSE listed companies – status as on 16th August, 2015.)*

#### **1.2. Snapshot of Independent Directors of Indian Listed Companies**

- ✓ 4,694 Independent Directors are on the boards of 1,492 NSE listed companies.
- ✓ These 4,694 individuals occupy a total of 6,281 independent directorship positions on 1,461 NSE listed companies.
- ✓ These 4,694 individuals also occupy 428 non-independent directorship positions on 327 NSE listed companies.
- ✓ Of these 4,694 individuals –
  - 3,792 hold only 1 independent directorship position each in NSE listed companies.
  - 4,373 hold only independent directorship positions in NSE listed companies.
  - Only 633 are women (13.49%), occupying a total of 844 independent directorship positions in 796 NSE listed companies.
  - 125 individuals holding 145 independent directorship positions in NSE listed companies are foreign nationals.
  - 196 hold 5 or more 5 directorships in companies listed on NSE & BSE.
    - o 96 hold 5 or more than 5 independent directorships in NSE listed companies.

- o 258 individuals are from Civil services occupying 436 independent directorship positions in NSE listed companies.
- ✓ The average age of independent directors is 63 years.
- ✓ The youngest independent director is aged around 25 years and the oldest is around 96 years.
- ✓ 1,126 individuals who are above 70 years hold 2,020 independent directorship positions.
- ✓ 957 (20.39%) are Chartered Accountants, 80 (1.70%) are Company Secretaries and 17 (0.36%) are Cost Accountants.
- ✓ 384 (8.18%) are lawyers.
- ✓ 53 are medical doctors.
- ✓ 755 are engineers.
- ✓ There are a total of 6,281 independent directorship positions on 1,492 NSE listed companies, giving an average of 4.21 independent directors per company.

## 2. WHO IS AN INDEPENDENT DIRECTOR?

The **Cadbury Report** defines independent directors as persons who “apart from their directors’ fees and shareholdings, are independent of the management and free from any business or other relationships which could materially interfere with the exercise of their independent judgment.”

**Higgs’ definition** of Independent director is that “a non-executive director is considered independent when the board determines that the director is independent in character and judgment and there are no relationships or circumstances which could affect, or appear to affect, the director’s judgment”.

Definition of Independent Director within the meaning of **Rule 4200 of the NASDAQ Stock Market** –

“Independent director means a person other than an executive officer or employee of the company or any other individual having a relationship which, in the opinion of the issuer’s board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. The following persons shall not be considered independent:

- (A) A director who is, or at any time during the past three years was, employed by the company or by any parent or subsidiary of the company;
- (B) A director who accepted or who has a Family Member who accepted any compensation from the company in excess of \$ 100,000 during any period of twelve consecutive months within the three years preceding the determination of independence, other than the following:
  - (i) Compensation for board or board committee service;
  - (ii) Compensation paid to a Family Member who is an employee (other than an executive officer) of the company; or
  - (iii) Benefits under a tax-qualified retirement plan, or non-discretionary compensation, Provided, however, that in addition to the requirements contained in this paragraph (B), Audit committee members are also subject to additional, more stringent requirements under Rule 4350(d).

- (C) A director who is a Family Member of an individual who is, or at any time during the past three years was, employed by the company as an executive officer;
- (D) A director who is, or has a Family Member who is, a partner in, or a controlling shareholder or an executive officer of, any organisation to which the company made, or from which the company received, payments for property or services in the current or any of the past three fiscal years that exceed 5% of the recipient's consolidated gross revenues for that year, or \$ 200,000, whichever is more, other than the following:
  - (i) Payments arising solely from investments in the company's securities; or
  - (ii) Payments under non-discretionary charitable contribution matching programmes.
- (E) A director of the issuer who is, or has a Family Member who is, employed as an executive officer of another entity where at any time during the past three years any of the executive officers of the issuer serve on the compensation committee of such other entity; or
- (F) A director who is, or has a Family Member who is, a current partner of the company's outside auditor, or was a partner or employee of the company's outside auditor who worked on the company's audit at any time during any of the past three years.
- (G) In the case of an investment company, in lieu of paragraphs (A)–(F), a director who is an “interested person” of the company as defined in Section 2(a)(19) of the Investment Company Act of 1940, other than in his or her capacity as a member of the board of directors or any board committee.”

According to amended **Clause 49 of Listing Agreement** –

“Independent director shall mean a non-executive director, other than a nominee director of the company:

- a. Who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;
- b.
  - (i) Who is or was not a promoter of the company or its holding, subsidiary or associate company;
  - (ii) Who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

- c. Apart from receiving director's remuneration, has or had no material pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;
- d. None of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;
- e. Who, neither himself nor any of his relatives –
  - (i) Holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;
  - (ii) Is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of –
    - (A) A firm or auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company, or
    - (B) Any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent or more of the gross turnover of such firm;
  - (iii) Holds together with his relatives two per cent or more of the total voting power of the company; or
  - (iv) Is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives twenty-five per cent or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent or more of the total voting power of the company;

(v) Is a material supplier, service provider or customer or a lessor or lessee of the company;

f. Who is not less than 21 years of age.

According to Section 149(6) of the Companies Act, 2013 -

“An independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director,—

- (a) Who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;
- (b)
  - (i) Who is or was not a promoter of the company or its holding, subsidiary or associate company;
  - (ii) Who is not related to promoters or directors in the company, its holding, subsidiary or associate company;
- (c) Who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;
- (d) None of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;
- (e) Who, neither himself nor any of his relatives—
  - (i) Holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;
  - (ii) Is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of—
    - (A) A firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

- (B) Any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent or more of the gross turnover of such firm;
  - (iii) Holds together with his relatives two per cent or more of the total voting power of the company; or
  - (iv) Is a Chief Executive or director, by whatever name called, of any non profit organisation that receives twenty-five per cent or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent or more of the total voting power of the company; or
- (f) Who possesses such other qualifications as may be prescribed.”

In other words, independent director is defined to mean directors who apart from receiving director’s remuneration, do not have any other material pecuniary relation or transactions with the company, its promoters, its management or its subsidiaries, which in the judgment of the board may affect independence of judgment of directors.

#### **Origin of concept of Independent Directors**

The concept of “Independent Director’ entered the corporate world en route through US, though in latent form, as “outside director” supposed to fulfil the advisory role. The genesis of actual Independent Directors began only in 1970s, as part of Corporate Governance reforms to fulfill the monitoring role. During this transition period, concept of Independent Directors got widespread prevalence, and so is, their rise on boards and various mechanisms to enhance the independence criteria. The position of Independent Directors consolidated in the Corporate Governance framework during hostile takeover period, with recognition of their role in enhancing shareholders prosperity. Subsequently, number of frauds in UK resulted in commissioning of Cadbury Committee on Corporate Governance in 1992, which provided broadened definition of Independent Directors, their role and relation in the company. In 1997, Hampel committee (UK) and Blue Ribbon Committee (US), further defined and enhanced the role of Independent Directors.

The paradigm shift however, occurred after number of corporate failures like WorldCom and Enron, with passing of Sarbanes-Oxley (SOX) legislation. The act not only reinvented the role of Independent Directors but also made various corporate actions a necessity and increased the legal complexity. The SOX requires all the members of the audit committees to be independent with redefined roles and enforces strict penalties for any transgression. Higgs report (2003) on effectiveness of non-executive directors and Smith Report (2005) on audit committees, after the happenings in US, provided a big thrust to concrete the position of Independent Directors in Corporate Governance framework of UK.

### **Origin of concept of Independent directors in India**

The term “Independent Director” was first introduced in the Indian corporate arena through the Kumar Manglam Birla Committee, formulated by SEBI, to start up reforms in the area of Corporate Governance. It soon found entry into corporate books, after Clause 49 was incorporated in Listing Agreement by SEBI. The Birla Report stipulates, “Independent Directors are directors who apart from receiving directors’ remuneration do not have any other material pecuniary relationship or transactions with company, its promoters, its management or its subsidiaries, which in the judgement of the board may affect their independence of judgement”. In the background of Enron debacle and sequel to SOX in US, Ministry of Company Affairs (MCA, then known as DCA) then constituted, the Naresh Chandra Committee, which gave governance some more thought.

Committee recommendations were though much inclined towards audit and auditors; but it did brought some new thoughts to institution of Independent Directors. It recommended Independent Directors should not be less than fifty per cent of the board. Nominee directors of lending institutions should not be considered as independents. The recommendations encompassing the audit committees were identical to those of SOX, requiring all members of committee to be independent and having written charter for its function. It also provided impetus to Independent Directors’ remuneration, training and recommended to exempt them from criminal and civil liabilities. In 2003, SEBI constituted the Narayana Murthy Committee with terms overlapping with that of Chandra Committee, whose recommendations were incorporated in the Clause 49 by amending it in 2004.

The Murthy report adopted the same definition of Independent Directors as formulated by the Chandra Committee, however, without

the condition of nine-year term. It also pondered view on the qualification and remuneration of Independent Directors and stressed on the need for evaluating performance of non-executive directors. The committee also enhanced the view of previous Chandra Report on audit committee, redefining its role and responsibilities, however, rejected the treatment of nominee directors of financial institutions at par with Independent Director. Sequel to implementation of Murthy Committee recommendation in Clause 49, MCA constituted another committee in December 2004 under the Chairmanship of Shri J. J. Irani, to give Corporate Governance a legislative stamp by revamping the Companies Act, 1956.

The Irani Committee came up with several recommendations in relation to the Independent Directors that were in conflict with the extant Clause 49 and/or the views of the Murthy Committee, e.g. (a) providing for several exemptions based on size and extent of public ownership in a mandatory Corporate Governance framework so as to optimise compliance costs while maintaining a desired level of regulatory rigour; (b) the criteria for “independence” of Independent Directors is proposed to be weakened significantly; (c) the mandatory requirement of Independent Directors to constitute one-half of the Board be weakened to one-third of the total members of the Board (d) abolition of age limits for Independent Directors. The present Corporate Governance framework encompassing the Independent Directors is through Clause 49 based on the Murthy Report.

#### **Necessity of Independent directors on the Board**

There are several benefits that arise out of appointment of independent directors on the Board of a company –

- ✓ They compensate for the management weaknesses in a company.
- ✓ They not only strengthen the accounting controls, but also ensure legal and ethical behaviour at the company.
- ✓ They help a company survive, grow, and flourish over time through improved succession planning through membership in the various committees.
- ✓ They help in improving the brand of a company through contacts, expertise, and access to debt and equity capital.
- ✓ Last but not the least, independent directors act as a great source of well-conceived, binding, long-term decisions of a company.

### 3. WHAT IS CORPORATE GOVERNANCE?

Corporate Governance is generally understood as the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations.

“Corporate” is the adjective meaning “of or relating to a corporation” derived from the noun corporation. A corporation is an organisation created (incorporated) by a group of shareholders who have ownership of the corporation. “Governance” has Latin origins that suggest the notion of ‘steering’. It deals with the processes and systems by which an organisation or society operates.

In a narrow sense, corporate governance involves a set of relationship amongst the company’s management, its board of directors, shareholders and other stakeholders. These relationships, which involve various rules and incentives, provide the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

In a broader sense, however, good corporate governance is the extent to which companies are run in an open and honest manner – is important for overall market confidence, the efficiency of international capital allocation, the renewal of countries’ industrial bases, and ultimately the nations’ overall wealth and welfare.

Corporate governance is important for the following reasons:

- a) It lays down the framework for creating long-term trust between companies and the external providers of capital.
- b) It improves strategic thinking at the top by inducting independent directors who bring a wealth of experience, and a host of new ideas.
- c) It rationalises the management and monitoring of risk that a firm faces globally.
- d) It limits the liability of top management and directors, by carefully articulating the decision making process.
- e) It has long-term reputational effects among key stakeholders, both internally (employees) and externally (clients, communities, political/regulatory agents).

The main principles of corporate governance are:-

- Discipline – universally accepted behaviour
- Transparency – candid, accurate, timely information
- Independence – no board/committee conflicts (of interest)
- Accountability – by law/statute to company
- Responsibility – to relevant stakeholders
- Fairness – Current & future interests/minorities
- Social responsibility – Not discriminatory or exploitive environmentally and personally

#### 4. COMMITTEES ON CORPORATE GOVERNANCE

a) **Higgs Review**

**Sir Derek Alan Higgs** (3rd April, 1944 – 28th April, 2008) was an English businessman and merchant banker. He was knighted in 2004. After graduating from the University of Bristol in 1966, Sir Derek joined Price Waterhouse, a large accountancy firm, and after training he qualified as a Chartered Accountant. In 1969 he became a corporate finance executive at Baring Brothers, a merchant bank. He moved-on and joined S. G. Warburg & Co. in 1972 and continued his career in merchant banking. He was also a board member of several companies including Prudential, British Land, and Coventry City Football Club.

In 2002 the British Labour Government commissioned Sir Derek to chair the “*Review of the role and effectiveness of non-executive directors*”. The report, widely known as the “Higgs review” or “Higgs report”, was published on 20 January, 2003 and many of its recommendations for large companies have been implemented. It reviewed of the role and effectiveness of non-executive directors and of the audit committee, aiming at improving and strengthening the existing Combined Code. He advocated more provisions with more stringent criteria for the board composition and evaluation of independent directors. According to Higgs, the key characteristics of an effective unitary board are –

- A chairman who has a strong, complementary relationship with the chief executive and the members of the Board is a central element of an effective board.
- A proper balance of skills and experience and the need for boards to include both executive and non-executive directors in the boardroom, such that no one group or individual dominates.
- The Board as a whole should be well informed about the company.
- The non-executive directors should meet as a group at least once a year without the chairman or executive directors present. There should be a statement in the annual report on whether the non-executive directors have met without the chairman or executives present.

**b) Blue Ribbon Committee**

In October 1998, the New York Stock Exchange and the National Association of Securities Dealers created the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees. The Blue Ribbon Committee was headed by John C. Whitehead (Former Deputy Secretary of State and Retired Co-Chairman and Senior Partner Goldman, Sachs & Co.) and Ira M. Millstein (Senior Partner Weil, Gotshal & Manges LLP). In February 1999, the committee issued its report, which contains ten recommendations designed to (1) strengthen the independence of audit committees; (2) increase the effectiveness of audit committees; and (3) improve the relationship between boards and their audit committees the activities of auditors and management. In December 1999, the Securities Exchange Commission approved changes to its rules to implement several of the Blue Ribbon Committee's recommendations with respect to audit committee composition and practices. Some of the important recommendations of the Blue Ribbon Committee are as follows:

- 1) Members of the audit committee shall be considered independent.
- 2) Listed companies with a market capitalisation above \$ 200 million (or a more appropriate measure for identifying smaller-sized companies should have an audit committee comprised solely of independent directors.
- 3) An audit committee should have a minimum of three directors, each of whom is financially literate.
- 4) A formal written charter should be adopted by the listed company.
- 5) Audit committee for each reporting company to disclose in the company's proxy statement for its annual meeting of shareholders certain information with regard to the audit committee.
- 6) Audit committee charter for every listed company should specify that the outside auditor is ultimately accountable to the board of directors and the audit committee.
- 7) Audit committee charter for every listed company specify that the audit committee is responsible for ensuring its

receipt from the outside auditors of a formal written statement delineating all relationships between the auditor and the company.

- 8) Company's outside auditor should discuss with the audit committee.
- 9) A letter from the audit committee in the company's annual report.

**c) Cadbury Report**

The Cadbury Report, titled "*Financial Aspects of Corporate Governance*", is a report of the committee chaired by Adrian Cadbury that sets out recommendations on the arrangement of company boards and accounting systems to mitigate corporate governance risks and failures. The report was published in 1992. The report's recommendations have been adopted in varying degree by the European Union, the United States, the World Bank, and others. The Committee was set up in May 1991 by the Financial Reporting Council, the London Stock Exchange and the Accountancy Profession to address the financial aspects of corporate governance. Some of the main recommendations made are as follows:

- The majority of non-executive directors should be independent of management and free from any business or other relationship;
- Non-executive directors should be appointed for specified terms;
- Service contracts should not exceed three years;
- Executive remuneration should be subject to the recommendations of a Remuneration Committee made up entirely or mainly of non-executive directors; and
- An Audit Committee, comprising of at least three non-executives, should be established.

Sir George Adrian Hayhurst Cadbury (born 1929) is a member of the well-known Cadbury family. He joined the Cadbury business in 1952 and became Chairman of Cadbury Ltd. in 1965. He retired as Chairman of Cadbury Schweppes in 1989. He was a Director of the Bank of England from 1970-94 and of IBM

from 1975-94. He was Chairman of the UK Committee on the Financial Aspects of Corporate Governance which published its Report and Code of Best Practice (“Cadbury Report and Code”) in December 1992. He was member of the OECD Business Sector Advisory Group on Corporate Governance. His publications include: Ethical Managers Make Their Own Rules; The Company Chairman; Corporate Governance and Chairmanship: A Personal View.

**d) Greenbury Report**

The Greenbury Report released in 1995 was the product of a committee established by the United Kingdom Confederation of Business and Industry on corporate governance which was chaired by Sir Richard Greenbury. It followed in the tradition of the Cadbury Report and addressed a growing concern about the level of director remuneration. The modern result of the report is found in the Combined Code at section B. The four main issues that were dealt with are as follows:

- The role of a Remuneration Committee in setting the remuneration packages for the CEO and other directors;
- The required level of disclosure needed by shareholders regarding details of directors remuneration and whether there is the need to obtain shareholder approval;
- Specific guidelines for determining a remuneration policy for directors; and
- service contracts and provisions binding the company to pay compensation to a director, particularly in the event of dismissal for unsatisfactory performance.

Sir Richard Greenbury (born 1936) was chairman and chief executive of the British retailer Marks and Spencer from 1988 to 1999. During his tenure, the company continued to grow strongly until it reached its peak in 1997 and 1998 when it was the second most profitable retailer in the world after Wal-Mart, and the ninth largest company in Britain.

**e) Smith Report**

The Smith Report was a report on corporate governance submitted to the UK government in 2003. It was a report and proposed guidance by an FRC (Financial Reporting Council)

appointed group chaired by Sir Robert Smith. It was concerned with the independence of auditors in the wake of the collapse of Arthur Andersen and the Enron scandal in the US in 2002. Its recommendations now form part of the Combined Code on corporate governance, applicable through the Listing Rules for the London Stock Exchange. It was substantially influenced by the views taken by the EU Commission. One important point was that an auditor himself should look at whether a company's corporate governance structure provides safeguards to preserve his own independence.

**Robert Haldane Smith, Baron Smith of Kelvin** (born 8th August, 1944) is a Scottish businessman, most notably known as a former Governor of the British Broadcasting Corporation before the advent of the BBC Trust. He is the present Chancellor of the University of the West of Scotland. He is currently Chairman of The Weir Group plc and Scottish and Southern Energy and a non-Executive Director of 3i Group plc, Standard Bank Group Limited, and Aegon UK plc. He is also Patron of the Scottish Community Foundation. Smith was a member of the Financial Services Authority from 1997 to 2000 and is a member of the Financial Reporting Council. As Chairman of the FRC Group on Audit Committees Combined Code Guidance he was responsible for The Smith Report (2003).

**f) King Report**

In 1994 the King Report on Corporate Governance (King I) was published by the King Committee on Corporate Governance, headed by former High Court judge, Mervyn King S.C. King I, incorporating a Code of Corporate Practices and Conduct, was the first of its kind in the country and was aimed at promoting the highest standards of corporate governance in South Africa.

Over and above the financial and regulatory aspects of corporate governance, King I advocated an integrated approach to good governance in the interests of a wide range of stakeholders. Although groundbreaking at the time, the evolving global economic environment together with recent legislative developments necessitated that King I be updated. To this end, the King Committee on Corporate Governance developed the King Report on Corporate Governance for South Africa, 2002 (King II).

The **King Committee**, formed in 1993 by the Institute of Directors in Southern Africa (IoD) was established to investigate the role of boards of directors in South African firms. Chaired by businessman and former judge Mervyn E. King, the committee included Phillip Armstrong, Nigel Payne, and Richard Wilkinson. **Mervyn E. King** is senior counsel and former judge on the Supreme Court of South Africa, “Professor extraordinaire” at the College of Economic and Management Sciences of the University of South Africa, Chairman of the King Committee on corporate governance in South Africa, Member of the private sector advisory group on corporate governance to the World Bank and Chairman of the Eminent Persons Group to review the governance and oversight of the United Nations.

**g) Turnbull Report**

*“Internal Control: Guidance for Directors on the Combined Code”* (1999) also known as the “Turnbull Report” is a report drawn up with the London Stock Exchange for listed companies. The committee which wrote the report was chaired by Nigel Turnbull of The Rank Group plc. The report informs directors of their obligations under the Combined Code with regard to keeping good “internal controls” in their companies, or having good audits and checks to ensure the quality of financial reporting and catch any fraud before it becomes a problem. The Combined Code on Corporate Governance is a set of principles of good corporate governance and provides a code of best practice aimed at companies listed on the London Stock Exchange.

Nigel Turnbull graduated as a scientist from St. Andrews University and was then articled as an accountant in the City of London. He joined The Rank Group as finance director in 1987, retiring in 1999. He was chairman of the working party responsible for providing guidance to directors on internal control which created the Turnbull Report. In addition to his position with The Risk Advisory Group, he is on the council of the Institute of Chartered Accountants in England and Wales, and is chairman or non-executive director of a number of companies.

**h) Hampel Report**

The Hampel Committee was established in 1996 to review and revise the earlier recommendations of the Cadbury and

Greenbury Committees. It was recognised that good corporate governance will largely depend on the particular situation of each company. Hampel viewed governance from a strict principal/agent perspective regarding corporate governance as an opportunity to enhance long-term shareholder value, which was asserted as the primary objective of the company. This was a new development from the Cadbury and Greenbury Codes which had primarily focused on preventing the abuse of the discretionary authority entrusted to management. In particular, the report favoured greater shareholder involvement in company affairs. For example, while the report recommended that unrelated proposals should not be bundled under one resolution shareholders, particularly institutional shareholders, were expected to adopt a, 'considered policy' on voting.

Another key advance was in the area of accountability and audit. The Board was identified as having responsibility to maintain a sound system of internal control, thereby safeguarding shareholders' investments (although the Board was not required to report on the effectiveness of the controls). Further, the Board was to be held accountable for all aspects of risk management, as opposed to just the financial controls as recommended by Cadbury.

**i) The Kumarmangalam Birla Committee on Corporate Governance**

SEBI had constituted a Committee on May 7, 1999 under the chairmanship of Shri Kumarmangalam Birla, then Member of the SEBI Board "to promote and raise the standards of corporate governance". Based on the recommendations of this Committee, a new clause 49 was incorporated in the Stock Exchange Listing Agreements ("Listing Agreements").

**j) Narayana Murthy Committee Report**

The SEBI Committee on Corporate Governance (the "Committee") was constituted under the Chairmanship of Shri N. R. Narayana Murthy, Chairman and Chief Mentor of Infosys Technologies Limited. The Committee was constituted by SEBI to review the performance of corporate governance in the country as well as to determine the role of companies in responding to rumour and other price sensitive information circulating in the market in order to enhance the transparency and integrity of the market.

The Committee submitted its report to SEBI in February 2003. Some of the important recommendations are:

- 1) Audit committees of publicly listed companies should be required to review the following information mandatorily:
  - a. Financial statements and draft audit report, including quarterly/half-yearly financial information;
  - b. Management discussion and analysis of financial condition and results of operations;
  - c. Reports relating to compliance with laws and to risk management;
  - d. Management letters/letters of internal control weaknesses issued by statutory/internal auditors; and
  - e. Records of related party transactions.
- 2) All audit committee members should be “financially literate” and at least one member should have accounting or related financial management expertise.

**k) Adi Godrej Committee Report on Corporate Governance**

The committee, headed by industrialist Adi Godrej, was set up by the Corporate Affairs Ministry in March 2012, for framing a ‘National Corporate Governance Policy’ to suggest a comprehensive policy framework to enable corporate governance of highest quality in all classes of companies without impinging on their internal autonomy to order their affairs in their best judgment. The panel had the mandate to elicit opinions about the “necessity of having a formal policy document on corporate governance” besides examining the prospects for making sustainability reporting an integral part of the corporate governance policy framework. Also, the committee looked into steps needed for a “comprehensive policy framework to enable corporate governance of highest quality in all classes of companies without impinging on their internal autonomy to order their affairs in their best judgment”.

The ‘Guiding Principles of Corporate Governance’, formulated by the Committee set up by the Ministry of Corporate Affairs,

under the chairmanship of Mr. Godrej, presented some practical suggestions on strengthening corporate governance within the existing legal framework. The Principles aim to transform corporate governance from a 'tick-box' exercise to an actual roadmap. The guidelines were presented to Dr. M. Veerappa Moily, Minister for Corporate Affairs and Power at CII's 8th International Corporate Governance Summit held on 18th September, 2012 at Mumbai. The set of 17 guiding principles covers issues such as the tone at the top, board composition and diversity, gender diversity, lead independent director, succession planning, whistle blower, risk management, investor activism, etc.

## 5. CORPORATE GOVERNANCE FRAMEWORK IN INDIA

Clause 49 of the listing agreement with stock exchanges provides the code of corporate governance prescribed by SEBI for listed Indian companies. With the introduction of clause 49, compliance with its requirements is mandatory for such companies. Apart from this, there is the Corporate Governance Voluntary Guidelines, 2009 issued by the Ministry of Corporate Affairs. Corporate Governance guidelines have also been issued for insurance companies.

Guidelines on Corporate Governance for Central Public Sector Enterprises have also been issued on May 2010.

### Clause 49 of the Listing Agreement

SEBI, *vide* its circular dated February 21, 2000, specified principles of corporate governance and introduced a new clause 49 in the Listing agreement of the Stock Exchanges. Listing means admission of the securities to dealings on a recognised stock exchange. The securities may be of any public limited company, Central or State Government, quasi-governmental and other financial institutions/corporations, municipalities, etc.

The Securities and Exchange Board of India (SEBI), *vide* its circulars dated 17th April, 2014, had issued certain amendments to Clause 49 of the Listing Agreement. These amendments followed the overhaul in the corporate governance norms under the Companies Act, 2013 and the related rules. These amendments are aimed at aligning the SEBI requirements with the provisions of the 2013 Act and adopting best practices on corporate governance. The SEBI, subsequently, *vide* its circular dated 15th September, 2014, issued further amendments to Clause 49 to address the concerns and practical difficulties raised by market participants and to facilitate the listed companies to ensure compliance with the provisions of revised Clause 49 by also more closely aligning to the requirements of the Companies Act, 2013. The revised Clause 49 is applicable to all listed companies with effect from 1st October, 2014.

Clause 49 of the Listing Agreement will be applicable to all companies whose equity shares are listed on a recognised stock exchange. However, compliance with the provisions of Clause 49 will not be mandatory, for the time being, in respect of the following class of companies:

- a. Companies having paid-up equity share capital not exceeding ₹ 10 crore and Net Worth not exceeding ₹ 25 crore, as on the last day of the previous financial year;

**Provided** that where the provisions of Clause 49 becomes applicable to a company at a later date, such company shall comply with the requirements of Clause 49 within six months from the date on which the provisions became applicable to the company.

- b. Companies whose equity share capital is listed exclusively on the SME and SME-ITP Platforms.

For other listed entities which are not companies, but body corporate (e.g. private and public sector banks, financial institutions, insurance companies etc.) incorporated under other statutes, the revised Clause 49 will apply to the extent that it does not violate their respective statutes and guidelines or directives issued by the relevant regulatory authorities.

**Overview of Clause 49**

- I. Agrees to comply with the provisions of Clause 49
  - A. The Rights of Shareholders
  - B. Role of stakeholders in Corporate Governance
  - C. Disclosure and transparency
  - D. Responsibilities of the Board
    - 1. Disclosure of Information
    - 2. Key functions of the Board
    - 3. Other responsibilities
- II. Board of Directors
  - A. Composition of Board
  - B. Independent Directors
  - C. Non executive directors' compensation and disclosures
  - D. Other provisions as to Board and Committees
  - E. Code of Conduct
  - F. Whistle Blower Policy

- III. Audit Committee
  - A. Qualified and Independent Audit Committee
  - B. Meeting of Audit Committee
  - C. Powers of Audit Committee
  - D. Role of Audit Committee
  - E. Review of information by Audit Committee
- IV. Nomination and Remuneration Committee
- V. Subsidiary Companies
- VI. Risk Management
- VII. Related Party Transactions
- VIII. Disclosures
  - A. Related party transactions
  - B. Disclosure of Accounting Treatment
  - C. Remuneration of Directors
  - D. Management
  - E. Shareholders
  - F. Proceeds from public issues, rights issue, preferential issues, etc.
- IX. CEO/CFO certification
- X. Report on Corporate Governance
- XI. Compliance
  - Annexure X – Information to be placed before Board of Directors
  - Annexure XI – Format of Quarterly Compliance Report on Corporate Governance
  - Annexure XII – Suggested List of Items to Be Included In the Report on Corporate Governance in the Annual Report of Companies
  - Annexure XIII – Non-Mandatory Requirements

### **Corporate Governance Voluntary (CGV) Guidelines, 2009**

These guidelines have been issued by the Ministry of Corporate Affairs to further improve corporate governance standards and practices. These guidelines will provide corporate India a framework to govern themselves voluntarily as per the highest standards of ethical and responsible conduct of business. They have been put together based on CII task force recommendations under the chairmanship of Naresh Chandra and the recommendations made by Institute of Company Secretaries.

These guidelines being recommendatory in nature focus on fairness, transparency, accountability and responsibility by Indian companies. Corporate Governance Voluntary Guidelines are a set of standard practices which may be voluntarily adopted by the public companies, and big private companies.

The Guidelines have six major aspects:

- I. Board of Directors
  - a. Appointment of Directors
    - i. Appointments to the Board
    - ii. Separation of offices of Chairman and Chief Executive Officer
    - iii. Nomination Committee
    - iv. Number of companies in which an individual become a director
  - b. Independent Directors
    - i. Attributes of Independent directors
    - ii. Tenure of Independent director
    - iii. Independent directors to have the option and freedom to meet company management periodically
  - c. Remuneration of Directors
    - i. Remuneration
    - ii. Remuneration Committee

- II. Responsibilities of the Board
  - a. Training of Directors
  - b. Quality Decision Making
  - c. Risk Management
  - d. Evaluating its own performance
  - e. Reviewing company's system of Internal Control
- III. Audit Committee of the Board
  - a. Constitution
  - b. Powers
  - c. Roles and Responsibilities
- IV. Auditors
  - a. Appointment
  - b. Certificate of Independence
  - c. Rotation of Auditors
  - d. Clarity of Information
  - e. Internal Auditor
- V. Secretarial Audit
- VI. Institution of Mechanism for Whistle Blowing

These guidelines cover a number of additional areas such as clarity around the directors' roles and responsibilities, greater transparency in the appointment of independent directors, separation of the CEO and board chair roles, limits on directorships, tenure of independent directors, executive sessions, the constitution of remuneration panels and increased transparency and disclosures, structure of compensation for non-executive directors, clear responsibilities of the board in oversight of risk management, rotation of audit partners and firms, and institution of whistle-blowing practices.

An overview of provisions covering Independent Directors under CGV Guidelines, 2009 are given below –

**i. Attributes for Independent Directors**

The Board should put in place a policy for specifying positive attributes of Independent Directors such as integrity, experience and expertise, foresight, managerial qualities and ability to read and understand financial statements. Disclosure about such policy should be made by the Board in its report to the shareholders. Such a policy may be subject to approval by shareholders.

All Independent Directors should provide a detailed Certificate of Independence at the time of their appointment, and thereafter annually. This certificate should be placed by the company on its website, if any, and in case the company is a listed company, also on the website of the stock exchange where the securities of the company are listed.

**ii. Tenure for Independent Director**

An Individual may not remain as an Independent Director in a company for more than six years. A period of three years should elapse before such an individual is inducted in the same company in any capacity. No individual may be allowed to have more than three tenures as Independent Director in the manner suggested above. The maximum number of public companies in which an individual may serve as an Independent Director should be restricted to seven.

**iii. Independent directors to have the option and freedom to meet company management periodically**

In order to enable Independent Directors to perform their functions effectively, they should have the option and freedom to interact with the company management periodically. Independent Directors should be provided with adequate independent office space and other resources and support by the companies including the power to have access to additional information to enable them to study and analyse various information and data provided by the company management.

### **Corporate Governance Guidelines for Insurance companies**

The Insurance Regulatory and Development Authority has issued comprehensive corporate governance guidelines for insurance companies, consolidating the various regulations notified by it from time to time, covering different operational areas. The guidelines are on the lines of SEBI's regulations on corporate governance for listed corporations.

With respect to the board composition for insurance companies, 50 per cent of the members should be independent if the Chairman's post is non-executive, and one-third independent if the company has an executive Chairman, according to the guidelines.

Auditors, actuaries, directors and senior managers should not simultaneously hold two positions in the insurance company that can result in a conflict of interest. (Under the Insurance Act, life insurance agents cannot be directors of a life insurance company. Also, there shall be no common directorship between life insurance companies).

Directors of insurance companies also have to make a declaration that they have not come under adverse notice of any tax or regulatory agency or any other professional body.

They are also required to enter into a deed of understanding to ensure that there is a clear understanding of the mutual role of the company and the board in relation to any corporate governance matter.

The guidelines have recommended the audit, investments, risk management policy holder protection, and asset liability management committees (for life insurance companies) as mandatory.

It also recommends encouragement of a whistle-blower policy so that employees may raise concern about possible irregularities.

### **Corporate Governance Guidelines for Central Public Sector Enterprises (CPSEs)**

Central Public Sector Enterprises (CPSEs) are those companies in which the direct holding of the Central Government or other CPSEs is 51% or more. As on 31-3-2014 there were 290 Central Public Sector Enterprises wherein, 169 are Holding CPSEs and 121 are Subsidiaries.

Majority of these CPSEs are earning profit and have improved their financial performance over the years. CPSEs are expected to expand international operations and become global giants, for which effective Corporate Governance is imperative. Guidelines on Corporate

Governance have been formulated with the objective that the CPSEs follow the guidelines in their functioning. Proper implementation of these guidelines would protect the interest of shareholders and relevant stakeholders.

The Department of Public Enterprises (DPE) had issued guidelines on composition of Board of Directors of Central Public Sector Enterprises (CPSEs) in 1992. According to these guidelines at least one-third of the Directors on the Board of a CPSE should be non-official Directors.

In November 2001, DPE issued further guidelines on the composition of Board of Directors of listed CPSEs. It provided that the number of Independent Directors should be at least one-third of the Board if the Chairman is non-executive, and not less than 50% if the Board has an executive Chairman. Relevant extracts of Clause 49 of the Listing Agreement with Stock Exchanges issued by Securities and Exchange Board of India (SEBI) forms part of the said guidelines.

To bring in more transparency and accountability in the functioning of CPSEs, the Government in June, 2007 introduced, for an experimental period of one year, the Guidelines on Corporate Governance for CPSEs. These Guidelines were of voluntary nature. Since the issue of these guidelines, the CPSEs have had the opportunity to implement them for the whole of the financial year 2008-09. These Guidelines have been modified and improved upon based on the experience gained during the experimental period of one year. The Government felt the need for continuing the adoption of good Corporate Governance Guidelines by CPSEs for ensuring higher level of transparency and decided to make these Guidelines mandatory and applicable to all CPSEs.

For the purpose of evolving Guidelines on Corporate Governance, CPSEs have been categorised into two groups, namely, (i) those listed on the Stock Exchanges; (ii) those not listed on the Stock Exchanges.

As far as listed CPSEs are concerned, they have to follow the SEBI Guidelines on Corporate Governance. In addition, they shall follow those provisions in these Guidelines which do not exist in the SEBI Guidelines and also do not contradict any of the provisions of the SEBI Guidelines.

The non-listed CPSEs should follow the Guidelines on Corporate Governance issued by the Department of Public Enterprises (DPE).

The major headings covered under the Guidelines are –

- Board of Directors
- Audit Committee
- Remuneration Committee
- Subsidiary Companies
- Disclosures
- Report, Compliance and Schedule of Implementation

Some of the important provisions of these guidelines are:

- i. The number of functional directors (including CMD/MD) should not exceed 50% of the actual strength of the Board.
- ii. In case of CPSEs listed in Stock Exchanges, the number of independent directors should be at least 50% of Board Members.
- iii. In case of CPSEs not listed in the Stock Exchanges, at least one-third of the Board Members should be independent directors.
- iv. Nominee Directors appointed by an institution which has invested in or lent to the company will be deemed to be Independent Directors.
- v. A director should not be a member in more than 10 committees or act as Chairman of more than five committees across all companies in which he is a director.
- vi. It should be a mandatory annual requirement for every Director to inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.
- vii. The Board should periodically review compliance reports of all laws applicable to the company, prepared by the company as well as steps taken by the company to rectify instances of non-compliances.
- viii. The Board should lay down a code of conduct for all Board Members and senior management of the company.
- ix. The Board should have a formal statement of Board Charter which clearly defines the roles and responsibilities of the Board and individual directors.

- x. The Board should ensure the integration and alignment of the risk management system with the corporate and operational objectives and also that risk management is undertaken as a part of normal business practice and not as a separate task at set times.
- xi. The company concerned should undertake training programme for its new Board members (Functional, Government, Nominee and Independent) in the business model of the company including risk profile of the business of company, responsibility of respective Directors and the manner in which such responsibilities are to be discharged. They should also be imparted training on corporate governance, model code of business ethics and conduct applicable for the respective Directors.
- xii. The Audit Committee should have minimum three directors as members. Two-thirds of the members of audit committee should be independent directors.
- xiii. Each CPSE shall constitute a Remuneration Committee comprising of at least three Directors, all of whom should be part-time Directors (i.e. Nominee Directors or Independent Directors). The Committee should be headed by an Independent Director.
- xiv. At least one Independent Director on the Board of Directors of the holding company should be a Director on the Board of Directors of its subsidiary company.
- xv. A statement in summary form of transactions with related parties in the normal and ordinary course of business should be placed periodically before the Audit Committee.
- xvi. The company should lay down procedures to inform Board members about the risk assessment and minimisation procedures.
- xvii. There should be a separate section on Corporate Governance in each Annual Report of company, with details of compliance on Corporate Governance.
- xviii. The company should obtain a certificate from either the auditors or practicing Company Secretary regarding compliance of conditions of corporate governance as stipulated in the Guidelines.

- xix. Chairman's speech in Annual General Meeting (AGM) should also carry a section on compliance with Corporate Governance guidelines/norms and should form part of the Annual Reports of the concerned CPSE.
- xx. The CPSEs should submit quarterly progress reports, within 15 days from the close of each quarter, in the format given in the guidelines, to respective Administrative Ministries/Departments. The Administrative Ministries will consolidate the information obtained from the CPSEs and furnish a comprehensive report to the Department of Public Enterprises by 31st May of every financial year on the status of compliance of Corporate Governance Guidelines during the previous financial year by the CPSEs under their jurisdiction.

Under these guidelines, the expression "**Independent Director**" shall mean a part-time Director of the company who:

- (a) Apart from receiving Director's remuneration, does not have any material pecuniary relationship or transaction with the company, its Directors, its senior management or its holding company, its subsidiaries and associates which may affect independence of the Director;
- (b) Is not related to persons occupying management positions at the Board level or at one level below the Board;
- (c) Has not been a senior executive or managerial personnel of the company in the immediately preceding three financial years;
- (d) Is not a partner or an executive, or was not a partner or an executive during the preceding three years, of any of the following:
  - i) The statutory audit firm or the internal audit firm or tax audit firm or energy audit firm or management audit firm or risk audit firm or insurance audit firm that is associated with the company, and
  - ii) The panel advocate(s) or legal firm(s) or consultant(s) and consulting firm(s) or expert(s) that have a material association with the company.
- (e) Is not a material supplier, service provider or customer or a lessor or lessee of the company, which may affect independence of the director;

- (f) Is not a substantial shareholder of the company i.e. owning two per cent or more of the block of voting shares.

For this purpose –

- (i) “Associate” shall mean a company which is an “associate” as defined in Accounting Standard 23 (AS-23), “Accounting for Investments in Associates in Consolidated Financial Statements”, issued by the Institute of Chartered Accountants of India.
- (ii) “**Senior management**” shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the Functional Directors, including all functional heads.
- (iii) “**Relative**” shall mean “relative” as defined in Section 2(41) and Section 6 read with Schedule IA of the Companies Act, 1956.

## 6. ROLE OF REGULATORS IN CORPORATE GOVERNANCE

### Who is a regulator / regulatory body?

Regulatory or regulator body is basically an independent organisation, usually established by government that regulates the activities of companies in an industry.

Regulators are external pressure points for good corporate governance. Mere compliance with regulatory requirements is not however an ideal situation in itself. In fact, mere compliance with regulatory pressures is a minimum requirement of good corporate governance and what are required are internal pressures, peer pressures and market pressures to reach higher than minimum standards prescribed by regulatory agencies.

### List of regulators in India

2. Securities and Exchange Board of India (SEBI) – [www.sebi.gov.in](http://www.sebi.gov.in)
3. Ministry of Corporate Affairs – [www.mca.gov.in](http://www.mca.gov.in)
4. Reserve Bank of India (RBI) – [www.rbi.org.in](http://www.rbi.org.in)
5. Airports Authority of India (AAI) - <http://www.airportsindia.org.in>
6. Telecom Regulatory Authority of India – [www.trai.gov.in](http://www.trai.gov.in)
7. Insurance Regulatory and Development Authority (IRDA) – [www.irdaindia.org](http://www.irdaindia.org)
8. Institute of Company Secretaries of India – [www.icsi.edu](http://www.icsi.edu)
9. Institute of Chartered Accountants of India (ICAI) – [www.icai.org](http://www.icai.org)
10. The Institute of Cost and Works Accounts of India (ICWAI) – [www.icwai.org](http://www.icwai.org)
11. Institute of Actuaries of India – <http://www.actuariesindia.org>
12. Competition Commission of India – [www.cci.gov.in](http://www.cci.gov.in)
13. Pension Fund Regulatory and Development Authority (PFRDA)– [www.pfrda.org.in](http://www.pfrda.org.in)
14. News Broadcasters Association (NBA) – [www.nbanewdelhi.com](http://www.nbanewdelhi.com)
15. Forward Markets Commission – [www.fmc.gov.in](http://www.fmc.gov.in)

16. Medical Council of India – [www.mciindia.org](http://www.mciindia.org)
17. Bar Council of India – [www.barcouncilofindia.org](http://www.barcouncilofindia.org)
18. Petroleum and Natural Gas Regulatory Board – [www.pngrb.gov.in](http://www.pngrb.gov.in)
19. Central Electricity Regulatory Commission – [www.cercind.gov.in](http://www.cercind.gov.in)
20. Khadi and Village Industries Commission – [www.kvic.org.in](http://www.kvic.org.in)
21. Office of Controller of Certifying Authorities – [www.cca.gov.in](http://www.cca.gov.in)
22. Food Safety & Standards Authority of India (FSSAI) – [www.fssai.gov.in](http://www.fssai.gov.in)
23. Central Pollution Control Board – [www.cpcbnic.in](http://www.cpcbnic.in)
24. Director General of Civil Aviation – [www.dgca.nic.in](http://www.dgca.nic.in)
25. Director General of Shipping – [www.dgshipping.com](http://www.dgshipping.com)
26. Director General of Foreign Trade – [www.dgft.org](http://www.dgft.org)
27. Ministry of Micro, Small and Medium Enterprises – <http://msme.gov.in>
28. Department of Public Enterprises - <http://dpe.nic.in>

### **Role of regulators in harmonizing corporate governance**

#### **Ministry of Corporate Affairs (MCA)**

The Ministry of Corporate Affairs is the main authority for regulating and promoting efficient, transparent and accountable form of corporate governance in the Indian corporate sector. It is constantly working towards improvement in the legislative framework and administrative set up, so as to enable easy incorporation and exit of the companies, as well as convenient compliance of regulations with transparency and accountability in corporate Governance. It is primarily concerned with administration of the Companies Act, 2013 and related legislations.

#### **Insurance Regulatory and Development Authority (IRDA)**

Insurance Regulatory Development Authority has been entrusted with the regulatory responsibility to protect the interests of the policyholders and accordingly would like to ensure that appropriate governance practices are in place in the insurance companies for maintenance of solvency, sound long term investment policy and

assumption of underwriting risks on a prudential basis, particularly as most of the insurance companies are yet to be listed.

IRDA has therefore evolved Corporate Governance Guidelines for Insurance companies which will become effective from the financial year commencing April 1, 2010. These guidelines have been evolved to ensure fairer corporate governance in public and private insurance companies to safeguard the investments of lakhs of policy holders and stakeholders as most of the insurance companies are not listed and could be open to risks.

The objective of the guidelines is to ensure that the structure, responsibilities and functions of Board of Directors and the senior management of the company fully recognise the expectations of all stakeholders as well as those of the regulator. The structure should take steps required to adopt sound and prudent principles and practices for the governance of the company and should have the ability to quickly address issues of non-compliance or weak oversight and controls. These guidelines therefore amplify on certain issues which are covered in the Insurance Act, 1938 and the regulations framed there under and include measures which are additionally considered essential by IRDA for adoption by insurance companies.

According to Section 14 of the IRDA Act, 1999, some of the important functions of the regulatory authority include:

- Protection of the interests of the policy holders in matters concerning assigning of policy, nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;
- Promoting efficiency in the conduct of insurance business;
- Calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organisations connected with the insurance business; etc.

Hence the Insurance Regulator has an important responsibility of protecting the interests of several policyholders and it needs to ensure that good governance practices are in place for maintenance of solvency, sound long-term investment policy and assumption of underwriting risks on a prudential basis.

### **Reserve Bank of India (RBI)**

Financial institutions in India can be divided into the following:

- Term-Lending Institutions, governed by the Companies Act, 2013.
- Banks (public sector, private sector (old and new generation banks, Co-operative Banks) governed by Banking Regulation Act, 1949.
- Finance companies also known as non-banking financial companies (NBFC) governed by Companies Act, 2013 and guidelines issued by RBI.

From the perspective of banking industry, corporate governance also includes in its ambit the manner in which their boards of directors govern the business and affairs of individual institutions and their functional relationship with senior management. This is determined by how banks:

- Set corporate objectives (including generating economic returns to owners);
- Run the day-to-day operations of the business and;
- Consider the interests of recognised stakeholders i.e., employees, customers, suppliers, supervisors, governments and the community and
- Align corporate activities and behaviours with the expectation that banks will operate in a safe and sound manner, and in compliance with applicable laws and regulations; and also protect the interests of depositors, which is supreme.

Reserve Bank of India has taken various steps to promote corporate governance in the Indian Banking System. These can broadly be classified into the following three categories: a) Transparency b) Off-site surveillance c) Prompt corrective action.

To accurately evaluate a bank's disclosures about its financial position and financial performance and its risks and risk management strategies, market participants and supervisors need fundamental information about the bank's business, management and corporate governance. Such information can help provide the appropriate perspective and context to understand a bank's activities and help in the effective operation of market discipline which would indirectly address any weaknesses in corporate governance and also encourage

enhanced role of corporate governance on the level and quality of disclosures. Thus transparency and good corporate governance can be seen as complementary issues – like two sides of the same coin.

The off-site surveillance mechanism is also active in monitoring the movement of assets, its impact on capital adequacy and overall efficiency and adequacy of managerial practices in banks. RBI also brings out the periodic data on “Peer Group Comparison” on critical ratios to maintain peer pressure for better performance and governance.

Prompt corrective action has been adopted by RBI as a part of core principles for effective banking supervision. As against a single trigger point based on capital adequacy normally adopted by many countries, Reserve Bank in keeping with Indian conditions have set two more trigger points namely Non-Performing Assets (NPA) and Return on Assets (ROA) as proxies for asset quality and profitability. These trigger points will enable the intervention of regulator through a set of mandatory action to stem further deterioration in the health of banks showing signs of weakness.

As a regulator of financial institutions, the Reserve Bank of India can also ensure the following steps are carried out by financial institutions in the governance process:

- Establish strategic objectives and a set of corporate values that are communicated throughout the organisation.
- Set and enforce clear lines of responsibility and accountability throughout the organisation.
- Ensure that board members are qualified for their positions, have a clear understanding of their role in corporate governance and are not subject to undue influence from management or outside concerns.
- Ensure that there is appropriate oversight by senior management.
- Effectively utilise the work conducted by internal and external auditors, in recognition of the important control functions they provide.
- Ensure that compensation approaches are consistent with the organisation’s ethical values, objectives, strategy and control environment.

- Conduct corporate governance in a transparent manner.
- Ensure an environment supportive of sound corporate governance.

### **Airports Authority of India (AAI)**

The Airports Authority of India was formed on 1st April, 1995 to accelerate the integrated development, expansion and modernisation of the operational, terminal and cargo facilities at the airports in the country conforming to international standards.

To detect frauds, irregularities and encourage employees to come forward to the Audit Committee the concept of “Whistle Blower” was introduced in Clause 49 of the Listing Agreement by SEBI. According to this clause, “A company may establish a mechanism for employees to report to the management concerns about unethical behaviour, actual or suspected fraud or violation of the company’s code of conduct or ethics policy. This mechanism could also provide for adequate safeguards against victimisation of employees who avail of the mechanism and also provide for direct access to the chairman of the audit committee in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organisation.” This stipulation is mere recommendatory and not mandatory. The notable features of the ‘Whistle Blower Policy’ is as follows:

- i. Personnel who observe an unethical or improper practice (not necessarily a violation of law) will be able to approach the audit committee without necessarily informing their supervisors.
- ii. Companies should take measures to ensure that this right of access is communicated to all employees through means of internal circulars, etc. The employment and other personnel policies of the company should contain provisions protecting “whistle blowers” from unfair termination and other unfair prejudicial employment practices.
- iii. Company should annually affirm that it has not denied any employee; access to the audit committee of the company (in respect of matters involving alleged misconduct) and that it has provided protection to “whistle blowers” from unfair termination and other unfair or prejudicial employment practices.

- iv. Such affirmation should form part of the Board report on Corporate Governance that is required to be prepared and submitted together with the annual report.

The Corporate vigilance Department of the Airports Authority of India is committed to prevent occurrence of corruption and malpractices for streamlining the functioning in the organisation and continually improve the Quality Management System to facilitate the accomplishment of corporate mission and vision. By Govt. office Order No. 33/5/2004, the Central Vigilance Officer has been authorised to ensure that no punitive action is taken by any concerned Administrative authority against any person on perceived reasons / suspicion of being “whistle blower”.

#### **Department of Public Enterprises (DPE)**

The Department of Public Enterprises acts as a nodal agency for all Public Sector Enterprises (PSE) and assists in policy formulation pertaining to the role of PSEs in the economy as also in laying down policy guidelines on performance improvement and evaluation, financial accounting, personnel management and in related areas. It also collects, evaluates and maintains information on several areas in respect of PSEs. DPE also provides an interface between the Administrative Ministries and the PSEs.

The Government has brought about Guidelines on Corporate Governance for Central Public Sector Enterprises (CPSEs). These guidelines cover issues like composition of Board of Directors, setting up of Audit Committees, role and powers of Audit Committees, issues relating to subsidiary companies, disclosures, accounting standards, risk management, compliance and schedule of implementation, etc.

These guidelines though voluntary in nature should be followed by all CPSEs as proper implementation of these guidelines would protect the interests of shareholders and relevant stakeholders. The compliance with these guidelines requires to be reflected in the Directors' report, Annual Report and Chairman's speech in the Annual General Meeting. The Department would also grade the CPSEs on the basis of their compliance of the corporate governance guidelines.

## 7. IDEAL FRAMEWORK FOR CORPORATE GOVERNANCE

Ideal corporate governance is characterised by a firm commitment and adoption of ethical practices by an organisation across its entire value chain and in all of its dealings with a wide group of stakeholders encompassing employees, customers, vendors, regulators and shareholders (including the minority shareholders), in both good and bad times.

To achieve this, certain checks and practices should be embraced whole-heartedly.

- ✓ Code of Conduct should not only be for the directors and senior management, but should cover the entire organisation.
- ✓ The whistle blower policy should not be a mere document, but should be communicated across the organisation and also practiced.
- ✓ Appointment of independent directors should not be a mere ritual to comply with the law, but the process of selection itself should be rigorous, transparent and in line with the company's needs.
- ✓ Diversity of skills on the Board of directors is essential for effective risk management.
- ✓ Compensation of directors and senior management should be related to their performance in the company's affairs.
- ✓ Criteria for performance should be based on transparency and measures taken by the directors in relation to the betterment of the company.
- ✓ Effectiveness of corporate governance should be monitored by exclusive specialists in corporate governance.
- ✓ In case of non-compliance the directors should be held responsible not only by the regulators but also by the company.

Corporate governance rests on four pillars i.e. –

- transparency,
- full disclosure,
- independent monitoring and
- being fair to all, especially to minority shareholders.

The Corporate Governance framework should ensure that timely and accurate disclosures are made on all material matters regarding the corporation, including financial situation, performance, ownership and governance of the company. Further good corporate governance also lowers the cost of capital by reducing risk and creates higher firm valuation thereby boosting real investments.

## 8. ROLE OF INDEPENDENT DIRECTORS

An important role that independent directors play in relation to the Board is the objective view they bring in while evaluating the board and management decisions thus creating a balance in the interest of the shareholders. These areas may include executive remuneration, succession planning, changes in corporate control, takeovers and acquisitions and the audit function. In fact independent directors are a core resource in delivering the good governance processes that shareholders expect.

As members of the Board, independent directors primarily provide inputs to all key decisions such as strategies, performance evaluation and risk evaluation affecting the company. Their significant contribution is also expected in matters relating to the committee in which they are members. In view of the faith imposed on them by various agencies they are more bound to execute their functions with impartiality.

The shareholders look up to the independent directors for providing transparency in respect of the disclosures in the working of the company as well as providing balance towards resolving conflict areas. While evaluating the board's decisions in respect of employees, creditors and other suppliers of major service providers, independent directors have a significant role in protecting the stakeholders' interests. One of the mandatory requirements of audit committee is to look into the reasons for default in payments to deposit holders, debentures, non-payment of declared dividend and creditors. Further they are required to review the functioning of the Whistle blower mechanism and related party transactions. These, essentially safeguard the interests of the stakeholders.

Independent directors are therefore seen as a check on the management of a company, as an oversight mechanism apart from the value addition that they bring to board deliberations. This is to ensure that wrong actions by the majority stakeholders who control the management by holding a majority of the company's shares are not hampered.

Major responsibilities of independent directors include:

- ✓ Thorough preparation for the meeting.
- ✓ Clarity in forming sound decisions relating to the company and its business.

- ✓ Free and frank expression of opinions.
- ✓ Commitment to decisions made by the Board.
- ✓ Awareness of the latest developments in the areas of the company's operations.
- ✓ Up-to-date information on laws and regulations governing the company.
- ✓ Last but not the least, responsibility to act in the larger interest of true growth and development of the company.

#### **8.1. Under the Listing Agreement**

The concept of independent directors was first brought to India in 1999 by the Kumarmangalam Birla committee on corporate governance. Kumaramangalam Birla Report states that independent directors are directors who apart from receiving director's remuneration do not have any other material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in the judgment of the board may affect their independence of judgment.

Three years later the Naresh Chandra committee gave governance more thought. Finally, in 2004 the Narayana Murthy committee affected changes to clause 49 of the listing agreement. The erstwhile Companies Act of 1956 did not mention about independent directors, only SEBI had defined independent director in Clause 49 of the Listing Agreement. But now the present Companies Act of 2013 has also defined the term independent director under Sec. 149(6).

#### **Meaning of Independent Director**

As per revised clause 49 of the Listing Agreement issued by the Securities and Exchange Board of India (SEBI), the expression "Independent director shall mean a non-executive director, other than a nominee director of the company:

- a. Who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;
- b.
  - (i) Who is or was not a promoter of the company or its holding, subsidiary or associate company;
  - (ii) Who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

- c. Apart from receiving director's remuneration, has or had no material pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;
- d. None of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;
- e. Who, neither himself nor any of his relatives –
  - (i) Holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;
  - (ii) Is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of —
    - (A) A firm or auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company, or
    - (B) Any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent or more of the gross turnover of such firm;
  - (iii) Holds together with his relatives two per cent or more of the total voting power of the company; or
  - (iv) Is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives twenty-five per cent or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent or more of the total voting power of the company;

- (v) Is a material supplier, service provider or customer or a lessor or lessee of the company;
- f. Who is not less than 21 years of age.

*Explanation*

- a. Associate shall mean a company which is an “associate” as defined in Accounting Standard (AS) 23, “Accounting for Investments in Associates in Consolidated Financial Statements”, issued by the Institute of Chartered Accountants of India.
- b. “Key Managerial Personnel” shall mean “Key Managerial Personnel” as defined in section 2(51) of the Companies Act, 2013.
- c. “Relative” shall mean “relative” as defined in section 2(77) of the Companies Act, 2013 and rules prescribed there under.

**Limit on number of directorships**

A person should not serve as an independent director in more than seven listed companies. Any person who is serving as a whole time director in any listed company should serve as an independent director in not more than three listed companies.

**Maximum tenure of Independent Directors**

The maximum tenure of Independent Directors will be in accordance with the Companies Act, 2013 and clarifications/ circulars issued by the Ministry of Corporate Affairs, in this regard, from time to time. The Act provides for a maximum tenure of 5 consecutive years in 1 term, companies may appoint independent director for a period lesser than 5 years. Further the Act provides that an independent director can hold 2 consecutive terms of 5 years each and can be re-appointed only after the cooling off period of 3 years. To illustrate this with an example, an independent director can be appointed for 2 consecutive terms of 2 years each and although the total tenure would be less than 10 years, the director can be re-appointed only after the cooling off period of 3 years.

**Formal letter of appointment to Independent Directors**

The company should issue a formal letter of appointment to independent directors in the manner as provided in the Companies Act, 2013. The terms and conditions of appointment should be disclosed on the website of the company.

### **Performance evaluation of Independent Directors**

The Nomination Committee should lay down the evaluation criteria for performance evaluation of independent directors. The company should disclose the criteria for performance evaluation, as laid down by the Nomination Committee, in its Annual Report. The performance evaluation of independent directors should be done by the entire Board of Directors (excluding the director being evaluated). On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.

### **Separate meetings of the Independent Directors**

The independent directors of the company should hold at least one meeting in a year, without the attendance of non-independent directors and members of management. All the independent directors of the company should strive to be present at such meeting. The independent directors in the meeting should –

- Review the performance of non-independent directors and the Board as a whole;
- Review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;
- Assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

### **Familiarisation programme for Independent Directors**

The company should familiarise the independent directors with the company, their roles, rights, responsibilities in the company, nature of the industry in which the company operates, business model of the company, etc., through various programmes. The details of such familiarisation programmes should be disclosed on the company's website and a web link thereto should also be given in the Annual Report.

### **Non-executive Directors' compensation and disclosures**

All fees/compensation, if any paid to non-executive directors, including independent directors, should be fixed by the Board of Directors and will require previous approval of shareholders in general meeting. The

shareholders' resolution should specify the limits for the maximum number of stock options that can be granted to non-executive directors, in any financial year and in aggregate. But the requirement of obtaining prior approval of shareholders in general meeting will not apply to payment of sitting fees to non-executive directors, if made within the limits prescribed under the Companies Act, 2013 for payment of sitting fees without approval of the Central Government.

### **Composition of Board**

According to Clause 49 of the Listing Agreement, the Board of Directors should consist of not less than 50% of non-executive directors.

In case the Chairman of the Board is a non-executive director, at least one third of the Board should comprise of independent directors and in case the company does not have a regular non-executive chairman, then at least half of the Board should comprise of Independent directors.

If the regular non-executive chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, then at least one-half of the Board of the company should consist of independent directors.

The Board should meet at least four times a year, with a maximum time gap of one hundred and twenty days between any two meetings.

### **Vacancy of Independent Director in the Board**

In case an independent director resigns or is removed from the Board of the Company, then he should be replaced by a new independent director at the earliest but not later than the immediate next Board meeting or three months from the date of such vacancy, whichever is later. If the company fulfils the requirement of independent directors in the Board even without filling the vacancy caused by such resignation or removal, then the requirement of replacement of independent director will not apply.

### **Code of Conduct**

A Code of Conduct should be prepared for all Board members and senior management of the company. It should also be posted on the website of the company. Further all board members and senior management personnel should affirm compliance with the code of

conduct on an annual basis. It should also be reflected in the Annual Report of the company in the form of a declaration signed by the CEO.

The Code of Conduct should also suitably incorporate the duties of independent directors as laid down in the Companies Act, 2013. An independent director will be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently with respect of the provisions contained in the Listing Agreement.

### **Audit Committee**

According to Clause 49 of the Listing Agreement, a qualified and independent audit committee should be set up.

The Audit Committee should have minimum three directors as members. Two thirds of the members of the audit committee should be independent directors. All members of the committee should be financially literate and at least one member should have accounting or related financial management expertise.

The Chairman of the Committee should be an independent director. The independent director being the Chairman of the Audit Committee should be present at the Annual General Meeting to answer shareholder queries.

The audit committee should meet at least four times in a year with a gap of not more than four months between two meetings. The quorum should be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent members present.

The Audit Committee has the following powers:

- To investigate any activity within its terms of reference.
- To seek information from any employee.
- To obtain outside legal or other professional advice.
- To secure attendance of outsiders with relevant expertise, if it considers necessary

### **Nomination and Remuneration Committee**

The Board of Directors should constitute the nomination and remuneration committee which should comprise at least three directors, all of whom should be non-executive directors and at least half should be independent. The chairman of the committee should be an independent director. The chairperson of the company (whether executive or non-executive) may be appointed as a member of the Nomination and Remuneration Committee but should not chair such Committee.

### **Subsidiary Companies**

At least one independent director on the Board of Directors of the holding company should be a director on the Board of Directors of a material non-listed Indian subsidiary company.

(For the purpose of this clause, a subsidiary shall be considered as material if the investment of the company in the subsidiary exceeds twenty per cent of its consolidated net worth as per the audited balance sheet of the previous financial year or if the subsidiary has generated twenty per cent of the consolidated income of the company during the previous financial year.)

### **Stakeholders Relationship Committee**

A committee under the chairmanship of a non-executive director and such other members as may be decided by the Board of the company should be formed to specifically look into the redressal of grievances of shareholders, debenture holders and other security holders. It shall consider and resolve the grievances of the security holders of the company including complaints related to transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends.

### **8.2. Under the Companies Act, 2013**

The Companies Act, 2013 was passed by the Lok Sabha on 18th December, 2012 and by the Rajya Sabha on 8th August 2013 paving way for a new modern company law. The legislation replaces the existing Companies Act 1956, which was enacted 57 years ago. The Companies Act, 2013 received the assent of the president on 29th August, 2013 and was notified in the Gazette of India on 30th August, 2013.

The Companies Act 2013 contains 29 Chapters, 7 Schedules, 470 sections as against the Companies Act, 1956 which consists of 658 sections under 13 parts and 15 schedules.

The new Act seeks to usher in more transparency and governance in the corporate bodies besides creating the necessary environment for growth in the present global structure. In 1956, there were just about a few thousand companies in the country. The number has now grown to more than a million now. Hence fewer regulations and self-regulation by the business houses was the need of the day.

In the Companies Act 2013, various new provisions have been included (which were not provided for in the Companies Act, 1956) for better governance of the companies. Some of the new provisions in a nutshell are:

- Requirement to constitute Remuneration and Nomination Committee and Stakeholders relationship committee
- Granting of more powers to Audit Committee
- Specific section pertaining to duties of directors
- Mode of appointment of independent directors and their tenure
- Code of Conduct for Independent directors
- Rotation of Auditors and restriction on Auditor's for providing non-audit services
- Enhancement of liability of Auditors
- Disclosure and approval of Related Party Transactions
- Mandatory Auditing Standards
- Enabling Shareholders Associations/Group of Shareholders for taking class action suits and reimbursement of the expenses out of Investor Education and Protection Fund
- Constitution of National Financial Reporting Authority, an independent body to take action against the Auditors in case of professional misconduct
- Requirement to spend on Corporate Social Responsibility (CSR) activities.

### **Provisions with regard to Independent Directors under the Companies Act, 2013**

Under the Companies Act, 2013, provision has been made for appointment of independent directors on the Board of listed companies, having such amount of paid up share capital as may be prescribed. In order to have better corporate governance and management of companies, the duties and liabilities of the directors have been specified in the Companies Act, 2013 and the term 'Independent Director' has also been defined.

In fact, the Act enhances the role of independent directors, who will be required to provide independent judgment on issues of strategy, performance, risk management, resources, key appointments and standards of conduct. They will also be required to scrutinise management performance and must satisfy themselves on the integrity of financial information.

The Companies (Appointment and Qualification of Directors) Rules, 2014 also contains provisions for independent directors.

#### **Definition**

Section 2(47): "Independent director" means an independent director referred to in sub-section (5) of section 149.

#### **Declaration by Board of Directors**

Section 134(3)(d)

Declaration to be given by independent directors to be annexed to every financial statement laid before a company in general meeting.

#### **Independent Director – Corporate Social Responsibility Committee**

Section 135:

Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year should constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director should be an independent director.

#### **Appointment of independent director by a listed company**

Section 149(4):

Every listed public company should have at least one-third of the total number of directors as independent directors and the Central

Government has prescribed the minimum number of independent directors in case of any class or classes of companies under Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

The following class or classes of companies should have at least two directors as independent directors -

- (i) Public Companies having paid up share capital of ten crore rupees or more; or
- (ii) Public Companies having turnover of one hundred crore rupees or more; or
- (iii) Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding fifty crore rupees:

In case a company covered under this rule is required to appoint a higher number of independent directors due to composition of its audit committee, such higher number of independent directors shall be applicable to it. Any intermittent vacancy of an independent director should be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy, whichever is later. Where a company ceases to fulfil any of three conditions laid down above for three consecutive years, it shall not be required to comply with these provisions until such time as it meets any of such conditions.

The paid up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account. Where a company belonging to any class of companies for which a higher number of independent directors has been specified in the law for the time being in force shall comply with the requirements specified in such law.

#### **Qualifications of independent director**

Rule 5 (Companies (Appointment and Qualification of Directors) Rules, 2014)

An independent director should possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company's business.

### **Who can be an Independent Director?**

Section 149(6):

“An independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director,—

- (a) Who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;
- (b) (i) Who is or was not a promoter of the company or its holding, subsidiary or associate company;
- (ii) Who is not related to promoters or directors in the company, its holding, subsidiary or associate company;
- (c) Who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;
- (d) None of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;
- (e) Who, neither himself nor any of his relatives—
  - (i) Holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;
  - (ii) Is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of—
    - (A) A firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

- (B) Any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;
  - (iii) Holds together with his relatives two per cent or more of the total voting power of the company; or
  - (iv) Is a chief executive or director, by whatever name called, of any non-profit organisation that receives twenty-five per cent or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent or more of the total voting power of the company; or
- (f) Who possesses such other qualifications as may be prescribed.”

#### **Declaration by Independent Director**

Section 149(7):

Every independent director should at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the circumstances which may affect his status as an independent director, give a declaration that he meets the criteria of independence as provided in sub-section (6) of Clause 149.

The company and independent directors should abide by the provisions specified in Schedule IV (Code for Independent Directors) of the Companies Act, 2013.

#### **Remuneration of Independent Director**

Section 149(9):

An independent director will not be entitled to any stock option and may receive remuneration by way of fee provided under sub-section (5) of section 197, reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members.

#### **Term of Independent Director**

Section 149(10):

Subject to the provisions of section 152, an independent director can hold office for a term up to five consecutive years on the Board of a

company, but will be eligible for reappointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report.

**Section 149(11)**

Notwithstanding anything contained in sub-section (10), no independent director should hold office for more than two consecutive terms, but such independent director will be eligible for appointment after the expiration of three years of ceasing to become an independent director: Provided that an independent director should not, during the said period of three years, be appointed in or be associated with the company in any other capacity, either directly or indirectly.

Section 149(13): The provisions with regard to retirement of directors by rotation will not be applicable to appointment of independent directors.

**Liability of Independent Directors**

Section 149(12):

An independent director will be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.

**Manner of selection of independent Directors**

Section 150:

An independent director may be selected from a data bank containing names, addresses and qualifications of persons who are eligible and willing to act as independent directors, maintained by any body, institute or association, as may be notified by the Central Government, having expertise in creation and maintenance of such data bank and put on their website for the use by the company making the appointment of such directors: Provided that responsibility of exercising due diligence before selecting a person from the data bank referred to above, as an independent director shall lie with the company making such appointment.

The appointment of independent director should be approved by the company in general meeting and the explanatory statement annexed to the notice of the general meeting called to consider the said appointment should indicate the justification for choosing the appointee for appointment as independent director.

### **Appointment of alternate director for an independent director**

Section 161(2):

A person who is proposed to be appointed as an alternate director for an independent director should be qualified to be appointed as an independent director under the provisions of the Act.

### **Creation and maintenance of databank of persons offering to become independent directors**

Any Body, institute or association, which has been authorised by the Central Government should create and maintain a data bank of persons willing and eligible to be appointed as independent director and such data bank will be placed on the website of the Ministry of Corporate Affairs or on any other website as may be approved or notified by the Central Government. The data bank will contain the following details in respect of each person included in the data bank to be eligible and willing to be appointed as independent director-

- (a) DIN (Director Identification Number);
- (b) Name and surname in full;
- (c) Income-tax PAN;
- (d) Father's name and mother's name and Spouse's name (if married) ;
- (e) Date of Birth;
- (f) Gender;
- (g) Nationality;
- (h) Occupation;
- (i) Full address with PIN Code (present and permanent);
- (j) phone number;
- (k) E-mail ID;
- (l) Educational and professional qualifications;
- (m) Experience or expertise, if any;
- (n) Any legal proceedings initiated or pending against such person;

- (o) The list of limited liability partnerships in which he is or was a designated partner along with –
  - (i) The name of the limited liability partnership;
  - (ii) The nature of industry; and
  - (iii) The duration- with dates;
- (p) The list of companies in which he is or was director along with -
  - (i) The name of the company;
  - (ii) The nature of industry;
  - (iii) The nature of directorship – executive or non-executive or managing director or Independent Director or Nominee Director; and
  - (iv) Duration – with dates.

A disclaimer should be conspicuously displayed on the website hosting the databank that a company must carry out its own due diligence before appointment of any person as an independent director and “the agency” maintaining the databank or the Central Government shall not be held responsible for the accuracy of information or lack of suitability of the person whose particulars form part of the databank.

Any person who desires to get his name included in the data bank of independent directors shall make an application to “the agency” in Form **DIR-1**. The agency can charge a reasonable fee from the applicant for inclusion of his name in the data bank of independent directors. Any person who has applied for inclusion of his name in the data bank of independent directors or any person whose name appears in the data bank, shall intimate to the agency about any changes in his particulars within fifteen days of such change.

#### **Meeting of the Board (shorter notice)**

Section 173(3):

A meeting of the Board may be called at shorter notice to transact urgent business subject to the condition that at least one independent director, if any, should be present at the meeting.

In case of absence of independent directors from such a meeting of the Board, decisions taken at such a meeting shall be circulated to all the

directors and will be final only on ratification thereof by at least one independent director, if any.

**Audit committee**

Section 177(2):

The Audit Committee should consist of a minimum of three directors with independent directors forming a majority.

**Nomination and Remuneration committee**

Section 178(1):

The Board of Directors of every listed company and such other class or classes of companies, as may be prescribed should constitute the Nomination and Remuneration Committee consisting of three or more non-executive directors out of which not less than one-half should be independent directors.

Rule 6 of Companies (Meetings of Board and its Powers) Rules, 2014:

The Board of directors of every listed company and the following classes of companies should constitute an Audit Committee and a Nomination and Remuneration Committee of the Board-

- (i) All public companies with a paid up capital of ten crore rupees or more;
- (ii) All public companies having turnover of one hundred crore rupees or more;
- (iii) All public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.

**Code for Independent Directors**

Schedule IV of the Companies Act, 2013 enumerates the standards and responsibilities expected from independent directors.

The Code is a guide to professional conduct for independent directors. Adherence to these standards by independent directors and fulfillment of their responsibilities in a professional and faithful manner will

promote confidence of the investment community, particularly minority shareholders, regulators and companies in the institution of independent directors. The Code contains the following –

- Guidelines of professional conduct
- Role and functions
- Duties
- Manner of appointment
- Reappointment
- Resignation or removal
- Separate meetings
- Evaluation mechanism

### **9. REQUIRED ATTRIBUTES OF AN INDEPENDENT DIRECTOR**

Although, the level of knowledge, integrity and independence necessary to carry out the functions of a director are difficult to summarise, a good independent director should be:-

- A person who possesses integrity.
- A person who has requisite business acumen.
- A person who is adequately trained.
- A person who participates actively.
- A person who is not afraid of performance reviews.
- A person who has adequate information.
- A person who commands the respect of his peers
- A person who has courage and ability to act.

The critical elements of a director being independent include:

- Independence to the management both in fact and perception by the public.
- Independent in thought and action i.e., qualitatively independent.
- Ability to deal with 'conflict of interest'.
- Knowledge of the industry.

Duties and Powers of Independent directors:

- Reduce potential conflict between specific interests of the management and wider interests of the company and shareholder
- Demand financial transparency
- Consider specific interests of the minority shareholder and employees
- Independent assessment while evaluating investment/expenditure/business plans
- Expertise – Technical / Financial / Experience
- Communication between management and shareholders
- Power to demand information

- Power to exercise his/her vote
- Power to govern

**Ten decisions to be taken by Independent directors before associating with a company–**

1. Question whether it is a company that you really want to work with;
2. Question whether you have the equipment and knowledge to meet the expectations of the company and its regulators, without assuming disproportionate risks;
3. Demonstrate that you are independent, as stipulated by law;
4. Enquire whether the company has developed formal control and oversight procedures, and determine whether you can rely on them;
5. Resist unreasonable pressures and maintain objectivity;
6. Keep yourself up-to-date on the subject matters where you are expected to contribute to board deliberations;
7. Obtain copies of the Code of Conduct and ensure that you can abide by it;
8. If you are in doubt, always seek professional help from experts;
9. Always demand all board-related papers well in advance, to prepare for board meetings;
10. Keep all company-related information strictly confidential.

## 10. LIABILITY OF INDEPENDENT DIRECTORS

An independent director should be held liable only in respect of any contravention of any provisions of the law, which had taken place with his knowledge (attributable through board processes) and where he has not acted diligently, or with his consent or connivance.

If the independent director does not initiate any action upon knowledge of any wrong, such director should be held liable. Knowledge should flow from the processes of the board. Additionally, upon knowledge of any wrong, follow up action / dissent of such independent directors from the commission of the wrong should be recorded in the minutes of the board meeting.

Apart from the basic directorial liability, being a director will invite liabilities under various Central, State and local laws. Usually notices, summons etc., are all addressed to all directors. Even searches conducted by Income Tax department find it difficult to distinguish between working directors and independent directors.

Any casual approach and negligence in performing the duty of trust and confidence by the Directors, can be termed as betrayal of the trust and such failure can result in unjustified and unreasonable losses on the shareholders and creditors and may help the Promoters Group to illegal wealth creation methods and for losses, the shareholders and other stakeholders involved in the company can legitimately file cases against all the Directors of the Company including the independent Directors and any talk of immunity to independent Directors from such prosecution will be illogical and contrary to the well-known cannons of justice and good governance.

Under Section 149(12) of the Companies Act, 2013, an independent director will be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through board processes and with his consent or connivance or where he had not acted diligently.

### 10.1. Directors and Officers Liability Insurance

In this era of heightened corporate scrutiny, greater transparency, increased litigation and criminal prosecutions—the personal exposure to directors and officers has never been greater. That is where the need for D&O liability insurance comes into picture. Many companies are now realising the importance of effective risk management and insurance protection and its role in a

corporate governance programme to help attract experienced directors.

Directors and Officers Liability Insurance (often called D&O) is insurance payable to the directors and officers of a company, or to the corporation itself, to cover damages or defence costs in the event they are sued for wrongful acts while they were with that company.

Directors & Officers Liability is the liability (or exposure to litigation) of corporate board members and officers arising out of their actions pertaining to their management duties of the corporation. Directors and Officers Liability Insurance insures the personal assets of corporate board members and officers (as well as the company's corporate assets) from lawsuits arising out of their capacity as directors or officers of the cooperation.

D&O insurance is usually purchased by the company itself, even when it is for the sole benefit of directors and officers. Reasons for doing so are many, but commonly would assist a company in attracting and retaining directors. In some cases while purchasing the insurance, the premium is split between the directors and the company, so as to demonstrate that the directors have paid a portion of the premium.

A common misperception of D&O insurance is that it makes directors or officers able to engage in acts they know to be wrong although this is not the case. Intentional acts are not covered in D&O insurance. Only negligence by directors or officers would be covered.

In a recent spate of litigation, a number of adverse court verdicts regarding the liability of directors and officers of companies to a third party were passed where the directors and officers were held personally liable for payment of compensation to the third party. Ordinarily, the directors and officers are bound by duty towards the company itself, shareholders, employees, creditors, customers, competitors, members of the public, government and other regulatory bodies. Any breach or non-performance in the duties can result in claims against the companies and/or its directors of the company by reason of any wrongful act in their respective capacity. The Directors' and Officers' Liability Insurance policy has been designed specifically to meet any financial liabilities imposed upon them.

This policy is necessary for directors and officers of every company if they wish to avoid potential litigation owing to-

- Failure of supervision.
- Inaccuracy in statements of financial accounts.
- Lack of judgment and good faith.
- Mismanagement of funds.
- Misstatements in prospectuses.
- Allotment of shares.
- Unauthorised loans or investments.
- Failure to obtain competitive bids.
- Imprudent expansion resulting in a loss.
- Using inside information.
- Unwarranted dividend payment, salaries or compensation.
- Misleading statements filed with the stock exchange.
- Misrepresentation in acquisition agreement for the purchase of another company.
- Wrongful dismissal of an employee.

**Risks covered**

This policy covers all claims made in event of-

- i. Mergers, takeovers and divestment.
- ii. Liquidation.
- iii. Changes in control of shareholding.
- iv. Share issues.
- v. Shareholder claims.
- vi. Misdeeds of co-directors.
- vii. Trustee accountability and responsibility.
- viii. Customs and excise allegations.

- ix. Administrative liabilities.
- x. Termination of employment.
- xi. Disposal of old firm/ entry of new owners.
- xii. Miscellaneous litigation.

#### **Compensation Offered**

The extent of indemnity being severely restricted by the Companies' Act will reimburse the extent of legal costs expended only if the Director/ Officer successfully defend the act taken against him.

Also, coverage is available on a 'claims made' basis and applies only to claims made against the Board of Directors during the policy period, irrespective of when the wrongful act occurred.

The cover applies to-

- Liabilities arising from any claim made against Directors and/ or Officers of the company by reason of any wrongful act in their respective capacity.
- Liabilities against the company where it is required to indemnify the Directors/Officers pursuant to common or statutory law provisions or Memorandum and Articles of Association.
- The company and its subsidiaries that are under the common control of the Directors/Officers.

#### **Exclusions**

- i. The policy will not pay for the losses arising from any claim.
- ii. Prior and pending litigation and claims submitted under previous policies.
- iii. Bodily injury, sickness, disease, emotional distress, death, damage or destruction of tangible property including loss.
- iv. Insured vs. insured. viz. directors suing each other.
- v. Illegal personal profit and remuneration.
- vi. Deliberate, dishonest or fraudulent acts.
- vii. Pollution and/ or contamination.
- viii. Insider trading.
- ix. Outside directorship (can be covered with specific information).

### **Directors and Officers Liability Claims**

Directors and Officers of both Public and Private Companies face legal liabilities in their service to the corporation. The claims experience between the two varies. Public Companies experience more frequency and severity of claims related to shareholder issues, while both Public and Private Companies face similar experience for Employment Related Claims. Below is a partial list of typical claimants:

- Shareholders
- Employees
- Creditors
- Customers/Clients
- Competitors
- Government Regulatory Agencies

D&O insurance helps the corporation to attract and retain quality board members.

## 11. TRAINING OF DIRECTORS

As a director of a company, he should have many different skills for the business to succeed. There should be compulsory training of directors at the time of induction into the company. The training should cover the roles, responsibilities and liabilities of a director. Training the directors makes it easier for them to address the issues in front of them and also easier to understand the challenges of the business.

There are several obligations that a director needs to be aware of under the Companies Act, 2013 and other regulations and there are also several other non-legal obligations for directors such as formation of strategy, management of team etc. Training can be very helpful for building both legal and non-legal skills areas.

The training programme should focus on leadership, strategy, delegation and team management. Further the training programme for directors should also focus on the following:

- a. Role and responsibilities of each individual director.
- b. Preparation for meetings.
- c. Company's organisation structure, objectives, vision and mission of the company.
- d. Implementation of strategies.
- e. Delegation of authority to management and review management's effectiveness.
- f. Regular assessment of training needs and skills of directors.

Apart from this, annual training programmes should also be conducted to enhance the skill set of directors and to keep abreast of the developments within and outside the company. Attendance of these training programmes should be monitored and made mandatory.

## **12. PERFORMANCE EVALUATION OF DIRECTORS**

Annual evaluation of all directors should be undertaken by the Board to evaluate its performance. The evaluation should not restrict itself to the Board but should include the various other committees of the company and the directors individually.

Individual evaluation should be able to show whether each director continues to contribute effectively and demonstrate commitment to the role (including commitment of time for board and committee meetings and other duties).

The chairman should act on the results of the performance evaluation by recognizing the strengths and addressing the weaknesses of the board and, where appropriate should propose appointment of new members to the board or seek the resignation of directors who have not performed well in the evaluation.

The board should state in the annual report about the performance evaluation of the board, its committees and its individual directors.

### 13. EXPECTED ROLE OF INDEPENDENT DIRECTORS

Independent directors are expected to take action in light of protecting general shareholder interests, such as raising opinions, etc., so that general shareholder interests are considered in such situations as business execution decisions made by the board of directors, etc. of listed companies.

General shareholder interests are basically taken care of through enhancing the corporate value of a listed company, and the role for such enhancement should be essentially borne by all directors and auditors of the listed company. The reason for requiring listed companies to appoint an independent director is that, due to general shareholders' lack of influence on company management and the high liquidity of the listed company's stocks in the market, the company management tends to neglect such general shareholder interests. Given that listed companies are required to secure at least one independent director and that an outside director is also eligible for the position, independent directors are expected to act to protect general shareholder interests. Such actions include encouraging board decisions which consider these interests through taking opportunities to express their opinions and raise issues, etc. from the viewpoint of general shareholder interests in the decision-making process, and sharing such opinions and issues with other directors on the board.

It is expected for independent directors to fulfil the role mentioned above by making appropriate decisions while considering the following points –

- Is the business execution decision, etc., of a listed company reasonable from the perspective of achieving business objectives of the company and enhancing its corporate value?
- Is there sufficient consideration for general shareholder interests?
- Is there enough information necessary for the independent director to properly evaluate business execution decisions, etc. provided in advance?
- Is there any structure/arrangement designed to accurately and appropriately disclose, the objective, content of the business execution decision, etc. and its effect on corporate value?

It is expected that an independent director appropriately exercises the rights of outside directors to protect general shareholder interests. The protection of general shareholder interests does not exclude, in a

situation which requires adjustments to manage conflicting interests of other stakeholders.

Measures that independent directors should take to protect general shareholder interests are not limited to preventing corporate misconduct and reining in activities that entail excessive risk. These measures may include, verbal statements encouraging proper action to realize the enhancement of corporate value, in situations where a decision related to business execution is to be made.

It is expected for an independent director to always remain highly sensitive to the voice and expectations of general shareholders. This does not mean receiving feedback directly from each individual shareholder.

It is expected of an independent director to always make considerations to maintain smooth communications with other directors, auditors, business executives and employees at the listed company. In order for an independent director/auditor to properly fulfil the role with regard to protecting general shareholder interests as mentioned above, it is necessary for all other directors, auditors, business executives, and employees at the listed companies to understand the role expected of independent directors, and make efforts to facilitate the proper functioning of the independent director system (such as developing a system to disseminate information in a timely and appropriate manner to independent directors, collaborating with departments, and securing support staff members).

#### 14. CODE FOR INDEPENDENT DIRECTORS

Just like we have a Code of Conduct for the employees and management of a company, there should be a separate Code for independent directors also.

The Code for independent directors should be drawn up by the Government under the Listing Agreement for effective implementation of the provisions of the Code.

The Code may contain the following points –

**A. Definition of Independent Director**

It should contain the definition of an Independent Director.

**B. Guidelines of Professional Conduct**

The Code should contain the guidelines for professional conduct of Independent Directors. It can have the following guidelines –

- (i) An Independent Director should devote sufficient time and attention to his/her professional obligations for informed and balanced decision making.
- (ii) An Independent Director should carry out his/her professional duties based with adherence to principles of care, loyalty and disclosure.
- (iii) An Independent Director should observe the law at all times and make every possible effort within the limits of his/her authority to ensure that the company observes the law likewise.
- (iv) In decision-making situations, an Independent Director should ensure that the decision would benefit the company, its shareholders and other stakeholders, providing a reasonable balance of interests.
- (v) In conflict situations, an Independent Director should be guided by the principles of increasing shareholder value and an equitable approach to the interests of all shareholder groups, and encourage the parties involved in the decision to adhere to the same principles.
- (vi) An Independent Director should not abuse his/her position to the detriment of the company or its shareholders or for the purpose of gaining direct or indirect personal

advantage or advantage for any other associated person, except for the remuneration for Board membership.

- (vii) An independent director should refrain from any actions that could lead to a loss of his/her independence. Where circumstances arise which make an Independent Director lose his/her independence, the Independent Director must immediately notify the shareholders, the management and the association accordingly.
- (viii) An independent Director should strive to establish constructive dialog with the company's Board of Directors and executive management. An independent director's ethical standards, decision making principles and reasons for disagreeing with a proposed decision should be clear for the Board of Directors and executive management.

**C. Professional activities of an Independent Director in relation to a company**

- (i) An independent director should strive to become familiar with the company's business, management structure and management personnel, the specifics of its business and markets, the types of state and commercial secrets with which he/she may come into contact, and the terms and conditions governing the use of such secrets.
- (ii) An independent Director is recommended to become personally familiar with the production, technological, social, environmental, financial and other specifics of the company's business, to gain a general overview of its most important and typical clients, and to visit the company's sites or main production (service) areas.
- (iii) An Independent Director should strive to attend all meetings of the Board of Directors.
- (iv) An Independent Director should assist the Board in establishing vision, mission and values and in setting strategy.
- (v) An Independent Director should assist the company in implementing best corporate governance and transparency standards.

- (vi) An independent director should inform the company's management and the Board of Directors of the negative consequences he/she is aware of, that may arise as a result of the failure to comply with the generally accepted corporate governance standards.
- (vii) An Independent Director should, acting within his/her authority, assist in protecting the legitimate interests of the company and its shareholders from illegal actions taken by third parties.
- (viii) When making decisions on material issues, an Independent Director should strive to possess sufficiently complete and accurate information to enable a reasoned and balanced decision to be made. An Independent Director should strive to ensure that the Board of Directors is supplied with the necessary information in advance. An Independent Director should pay special attention to the internal mechanisms of providing information, financial control and risk management.
- (ix) The priority issues on which an Independent Director must focus are preparing and holding meetings of shareholders and the Board of Directors, major transactions and transactions involving conflicts of interest, audit, securities issues, the disclosure of information on the company's operations, corporate culture and corporate social responsibility.
- (x) An Independent Director should make reasonable efforts to ensure that proposed decisions do not violate the law and/or infringe legitimate interests of shareholders. In particular, an Independent Director should pay special attention to prices of major transactions and interested-party transactions matching the market prices.
- (xi) In case of a conflict, an Independent Director should take an objective and unbiased attitude based on the principles of legitimacy, justice and equal treatment of all of the company's shareholders. An Independent Director should strive to settle such conflicts internally as soon as possible.
- (xii) In case of disagreement an Independent Director is recommended to insist upon writing his/her special opinion into the minutes of the Board of Directors' meeting.

- (xiii) An Independent Director should have the right to solicit advice from independent experts, the company's shareholders, and civil professional organizations, when making a decision on issues that are objectively difficult. In this respect the Independent Director shall not disclose information which may constitute a State or commercial secret according to applicable laws and common sense considerations.
- (xiv) In relations with the company, an Independent Director shall adhere to the principle of openness with respect to himself/herself as well as his/her affiliated parties.
- (xv) An Independent Director should get acquainted with all applicable laws and regulations in order to clearly understand potential liabilities arising from performing the duties of a Board member in a company. In case if such company's securities are traded on international markets, the Independent Directors is also recommended to get familiarized with liabilities, arising under the legislation of respective jurisdictions.

**D. Professional activities of an Independent Director in relation to shareholders**

- (i) An Independent Director acts as an agent of all the company shareholders and therefore should, within the limits of his/her authority, protect the rights and legitimate interests of all of the company's shareholders and help establish constructive dialogue between the company's shareholders and management.
- (ii) An Independent Director should strive to ensure that shareholders are provided with complete and timely information on the company's operations as stipulated by applicable laws.
- (iii) An Independent Director should strive to be accessible and open to shareholders.

**E. Professional activities of an Independent Director in relation to third parties**

- (i) An Independent Director may not maintain any relations with third parties, including the company's competitors and affiliated parties, if such relations are known to

cause direct or indirect damage to the image, business or legitimate interests of the company and its shareholders, regardless of whether such relations benefit the Independent Director or his/her affiliated parties.

- (ii) An Independent Director may not disclose information on the company that might affect the value of the company's shares, other assets or business to a specific group of persons on special conditions related to either the scope or the time-frame of such disclosure.
- (iii) An Independent Director should not disclose confidential information, including commercial secrets, technologies, advertising and sales promotion plans unless such disclosure is expressly approved by the Board of Directors or is required by law.

**F. To uphold the dignity and reputation of the profession**

- (i) An Independent Director should respect the professional standing of other independent directors and must not damage their business reputation by accident or intentionally.
- (ii) An Independent Director should strive to constantly improve his/her professional skills, including through participation in special training programmes.
- (iii) An Independent Director should participate in the activities of professional organizations promoting the profession of independent directors.
- (iv) An Independent Director should be open for exchange of experience and opinions with other members of the professional community.

Schedule IV of the Companies Act, 2013 provides for a Code for Independent Directors which is a guide to professional conduct for independent directors. Adherence to these standards by independent directors and fulfilment of their responsibilities in a professional and faithful manner will promote confidence of the investment community, particularly minority shareholders, regulators and companies in the institution of independent directors.

It covers the following aspects –

- Professional Conduct
- Role & Functions
- Duties
- Manner of Appointment/Re-appointment
- Resignation/removal
- Separate meetings
- Evaluation mechanism

## **15. CODE FOR INDEPENDENT DIRECTORS UNDER SCHEDULE IV OF THE COMPANIES ACT, 2013**

The Code is a guide to professional conduct for independent directors. Adherence to these standards by independent directors and fulfillment of their responsibilities in a professional and faithful manner will promote confidence of the investment community, particularly minority shareholders, regulators and companies in the institution of independent directors.

### **I. Guidelines of professional conduct:**

An independent director shall:

- (1) Uphold ethical standards of integrity and probity;
- (2) Act objectively and constructively while exercising his duties;
- (3) Exercise his responsibilities in a *bona fide* manner in the interest of the company;
- (4) Devote sufficient time and attention to his professional obligations for informed and balanced decision making;
- (5) Not allow any extraneous considerations that will vitiate his exercise of objective independent judgment in the paramount interest of the company as a whole, while concurring in or dissenting from the collective judgment of the Board in its decision making;
- (6) Not abuse his position to the detriment of the company or its shareholders or for the purpose of gaining direct or indirect personal advantage or advantage for any associated person;
- (7) Refrain from any action that would lead to loss of his independence;
- (8) Where circumstances arise which make an independent director lose his independence, the independent director must immediately inform the Board accordingly;
- (9) Assist the company in implementing the best corporate governance practices.

**II. Role and functions:**

The independent directors shall:

- (1) help in bringing an independent judgment to bear on the Board's deliberations especially on issues of strategy, performance, risk management, resources, key appointments and standards of conduct;
- (2) bring an objective view in the evaluation of the performance of board and management;
- (3) scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance;
- (4) satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible;
- (5) safeguard the interests of all stakeholders, particularly the minority shareholders;
- (6) balance the conflicting interest of the stakeholders;
- (7) determine appropriate levels of remuneration of executive directors, key managerial personnel and senior management and have a prime role in appointing and where necessary recommend removal of executive directors, key managerial personnel and senior management;
- (8) moderate and arbitrate in the interest of the company as a whole, in situations of conflict between management and shareholder's interest.

**III. Duties:**

The independent directors shall—

- (1) undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company;
- (2) seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice and opinion of outside experts at the expense of the company;

- (3) Strive to attend all meetings of the Board of Directors and of the Board committees of which he is a member;
- (4) Participate constructively and actively in the committees of the Board in which they are chairpersons or members;
- (5) Strive to attend the general meetings of the company;
- (6) Where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, insist that their concerns are recorded in the minutes of the Board meeting;
- (7) Keep themselves well informed about the company and the external environment in which it operates;
- (8) Not to unfairly obstruct the functioning of an otherwise proper Board or committee of the Board;
- (9) Pay sufficient attention and ensure that adequate deliberations are held before approving related party transactions and assure themselves that the same are in the interest of the company;
- (10) Ascertain and ensure that the company has an adequate and functional vigil mechanism and to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use;
- (11) Report concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy;
- (12) Acting within his authority, assist in protecting the legitimate interests of the company, shareholders and its employees;
- (13) Not disclose confidential information, including commercial secrets, technologies, advertising and sales promotion plans, unpublished price sensitive information, unless such disclosure is expressly approved by the Board or required by law.

**IV. Manner of appointment:**

- (1) Appointment process of independent directors shall be independent of the company management; while selecting independent directors the Board shall ensure that there is appropriate balance of skills, experience and knowledge in the Board so as to enable the Board to discharge its functions and duties effectively.
- (2) The appointment of independent director(s) of the company shall be approved at the meeting of the shareholders.
- (3) The explanatory statement attached to the notice of the meeting for approving the appointment of independent director shall include a statement that in the opinion of the Board, the independent director proposed to be appointed fulfils the conditions specified in the Act and the rules made thereunder and that the proposed director is independent of the management.
- (4) The appointment of independent directors shall be formalised through a letter of appointment, which shall set out :
  - a. the term of appointment;
  - b. the expectation of the Board from the appointed director; the Board-level committee(s) in which the director is expected to serve and its tasks;
  - c. the fiduciary duties that come with such an appointment along with accompanying liabilities;
  - d. provision for Directors and Officers (D and O) insurance, if any;
  - e. the Code of Business Ethics that the company expects its directors and employees to follow;
  - f. the list of actions that a director should not do while functioning as such in the company; and
  - g. the remuneration, mentioning periodic fees, reimbursement of expenses for participation in the Boards and other meetings and profit related commission, if any.

- (5) The terms and conditions of appointment of independent directors shall be open for inspection at the registered office of the company by any member during normal business hours.
- (6) The terms and conditions of appointment of independent directors shall also be posted on the company's website.

**V. Re-appointment:**

The re-appointment of independent director shall be on the basis of report of performance evaluation.

**VI. Resignation or removal:**

- (1) The resignation or removal of an independent director shall be in the same manner as is provided in sections 168 and 169 of the Act.
- (2) An independent director who resigns or is removed from the Board of the company shall be replaced by a new independent director within a period of not more than one hundred and eighty days from the date of such resignation or removal, as the case may be.
- (3) Where the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director shall not apply.

**VII. Separate meetings:**

- (1) The independent directors of the company shall hold at least one meeting in a year, without the attendance of non-independent directors and members of management;
- (2) All the independent directors of the company shall strive to be present at such meeting;
- (3) The meeting shall:
  - a. Review the performance of non-independent directors and the Board as a whole;
  - b. Review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;

- c. Assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

**VIII. Evaluation mechanism:**

- (1) The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated.
- (2) On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.

**16. USEFUL WEBSITES**

[www.sebi.gov.in](http://www.sebi.gov.in) – Securities and Exchange Board of India  
[www.mca.gov.in](http://www.mca.gov.in) – Ministry of Corporate Affairs, Government of India  
[www.dpe.nic.in](http://www.dpe.nic.in) - Department of Public Enterprises  
[www.rbi.org.in](http://www.rbi.org.in) – Reserve Bank of India

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**Mr. Rajkumar Adukia** is an eminent business consultant, advisor, author, and speaker. He is a rank holder from Bombay University, winner of most coveted award of his college Sydenham College of Commerce & Economics (at that point of time Best College of Asia) as best student of college namely Jeejeebhoy Cup for Proficiency and Character winner and did his graduation with Gold Medal for highest marks in Accountancy & Auditing. He is throughout gold medalist and passed the Chartered Accountancy, Company Secretary and Cost Accountancy Course and was among the top rank holders in all the courses.

Mr. Adukia also holds a degree in law and is an MBA, Dip. in IFRS(UK) & Diploma in Labour Law & Labour Welfare, IPR and Criminology. He has been involved in the activities of the Institute of Chartered Accountants of India since 1984 as a Convenor of Kalbadevi CPE Study Circle. He was the Chairman of the Western Region of Institute of Chartered Accountants of India in 1997 and has been actively involved in various committees of ICAI. He became a member of the Central Council in 1998 and ever since he has worked tirelessly towards knowledge sharing, professional development and enhancing professional opportunities for members.

He has served on the Board of Directors in the capacity of independent director at BOI Asset Management Co. Ltd. SBI Mutual Funds Management Pvt. Ltd. He is also a member of IFRS SME implementation Group of International Accounting Standards Board.

Mr. Adukia is Senior & Founder partner of Adukia & Associates established in 1984 handles assignments on internal audit, business advisory and planning, commercial law compliance, project work, taxation and trusts. His clientele include large corporations, owner-managed companies, small manufacturers, service businesses, property management and construction, exporters and importers, and professionals.

Based on his rich experience, he has written numerous articles on most aspects of corporate laws, income tax specially survey, search & seizure, finance-accounting, auditing, taxation, valuation, public finance. His authoritative articles appear regularly in financial papers like Business India, Financial Express, Economic Times and professional and business magazines. He has authored several accounting and auditing manuals. He has authored more than 100 books on vast range of topics including Internal Audit, Bank Audit, SEZ, CARO, PMLA, Anti-dumping, Income Tax Search, Survey and Seizure, IFRS, Carbon Credit, Private Equity, etc. Some of his books are on topics like time management, stress management etc. His books are known for their practicality and for their proactive approaches to meeting practice needs.

Mr. Adukia is a frequent speaker on trade and finance at seminars and conferences organised by the Institute of Chartered Accountants of India, various Chambers of Commerce, income tax offices and other professional associations. He has also lectured at the S.P. Jain Institute of Management, Intensive Coaching Classes for Inter & Final CA students and Direct Taxes Regional Training Institute of CBDT. He also develops and delivers short courses, seminars and workshops on changes and opportunities in trade and finance. He has extensive experience as a speaker, moderator and panellist at workshops and conferences held for both students and professionals across the country and abroad.

He was member of many committees of Government of India including J J Irani Committee which drafted initial version of Companies Act, 2013. He was member of all 3 standards board namely Accounting Standards Board, Cost Accounting Standards Board and Secretarial Standards Board respectively of ICAI, ICWAI & ICSI. He is founder president of Rotary Club of Bombay Sea Pearl, Bombay Gateway Junior Chamber and Giants Club of Kalbadevi.

Mr. Adukia has been actively involved in various committees to name a few.

- Member Regional Advisory Committee of Central Board of Excise & Customs
- Member of Standards Setting Committee of Bureau of Indian Standards.
- Member – Working Group constituted by the Competition Commission of India
- Member – Steering Committees for Reports on the Observance of Standards and Codes (ROSC) Study on Insolvency and Creditors Right and Corporate Governance.
- Ex Hon. Secretary to All India Manufacturers' Organisation, All India Importers' and Exporters' Association and Western India Chamber of Commerce.
- Hon. Consultant to Bombay Industries Association.
- Faculty member for Entrepreneurship Development Programme of Ministry of Industrial Development, Government of India.
- President – Association of Indian Investors (A Section 25 Company)
- Associated as Chairman/member of Income Tax Appellate Tribunal Bar Association, All India Manufacturers' Organisation.

He has delivered lectures abroad at forums of the International Federation of Accountants and has travelled very extensively three-fourths of the Globe. Currently he is in his 6th term as the Central Council Member and Chairman of the following Committees namely, Committee on Cooperatives and NPOs and Ind AS (IFRS) Implementation Committee.