

## CHAPTER 11- CORPORATE GOVERNANCE REFORMS IN INDIA

### KUMAR MANGALAM BIRLA COMMITTEE ON CORPORATE GOVERNANCE - MAJOR RECOMMENDATIONS:

These recommendations influenced SEBI's **Clause 49 of the Listing Agreement**, strengthening corporate governance in India.

1. **Audit Committee** – Recommended for establishment of an audit committee as a subcommittee of the board to act as an interface between the board and auditors of the company and required to oversee financial reporting, review the adequacy of internal control systems, recommend appointment & removal of auditors, etc. Minimum 3 members, **majority** be independent, **at least one member be financially literate**.
2. **Board Composition** – At least 1/3 of board to comprise independent directors if **chairman is non-executive** and at least 50% independent directors if **Chairman is executive**
3. **CEO and CFO Responsibilities** – Ensuring **fair presentation of financial statements**.
4. **Directors** – Companies should **adopt a Code of Conduct** for directors and board members.
5. **Establishment of Risk Management** – Companies should **establish a risk management framework**.
6. **Financial Disclosures** – Mandatory **quarterly financial reporting** and segment-wise disclosures. **Related-Party Transactions** should be **disclosed transparently** in financial statements.
7. **Other Important Recommendations** - Recommended setting up a **Remuneration Committee** to decide executive compensation. Greater **transparency in voting rights of shareholders and dividend policies**.

### NARAYAN MURTHY COMMITTEE ON CORPORATE GOVERNANCE – MAJOR RECOMMENDATIONS

The recommendations significantly shaped **Clause 49 of SEBI's Listing Agreement**, improving corporate governance in India.

1. **Audit Committee** – **Audit Committee's role expanded** -to review financial statements, operational results, compliance with laws and risk management; **all members to be financially literate**
2. **Board Independence** – **At least 50% independent directors** in all companies, regardless of Chairman type.
3. **CEO & CFO Certification** – CEO and CFO must **certify financial statements** to ensure accuracy.
4. **Directors** – **Mandatory adoption** of a Code of Conduct for directors and senior management.
5. **Establishment of Risk Management System**–The management should regularly place before the Board a **Report on risk assessment and minimisation procedures**.

6. **Financial Disclosures. Improving quality of financial disclosures by providing additional disclosures on risks and use of funds. Related-Party transactions must be approved by the Audit Committee.**
7. **Other Important Recommendations** - Companies must establish a **Whistleblower Mechanism** for reporting unethical behaviour. **Protection of minority shareholders' rights** and transparency in decision-making.

The Comparative chart of key recommendations of the **Kumar Mangalam Birla Committee** and the **Narayan Murthy Committee** on Corporate Governance:

<b>Recommendation</b>	<b>Kumar Mangalam Birla Committee</b>	<b>Narayan Murthy Committee</b>
<b>Audit Committee</b>	Minimum 3 members, <b>majority</b> be independent, <b>at least one member be financially literate</b>	<b>Audit Committee's role expanded</b> - to review financial statements, operational results, compliance with laws and risk management; <b>all members to be financially literate</b>
<b>Board Composition</b>	At least 1/3 of board to comprise independent directors <b>if chairman is non-executive</b> and at least 50% independent directors <b>if Chairman is executive</b>	At least 50% independent directors <b>in all cases</b>
<b>CEO/CFO</b>	To <b>ensure fair presentation</b> of financial statements	CEO & CFO to <b>certify accuracy</b> of financial statements
<b>Directors</b>	<b>Recommended adoption</b> of a code of conduct for <b>directors / board members</b>	<b>Mandatory</b> code of conduct for <b>directors and senior management</b>
<b>Establishment of Risk Management and internal controls</b>	<b>Recommended establishment</b> of a risk management system	<b>Emphasized risk assessment and mitigation of risks</b>
<b>Financial Disclosures</b>	<b>Quarterly</b> financial disclosures, <b>segment-wise reporting</b> , and <b>reporting of related-party transactions</b>	<b>Additional disclosures on risks, use of funds</b> , and related-party transactions <b>to be approved by Audit Committee</b>
<b>Other Important Recommendations</b>	Setting up of <b>Remuneration Committee</b>  Greater <b>transparency in voting and dividend policy</b>	Setting up of <b>Whistleblower Mechanism</b>  Protection of <b>minority shareholders' rights</b>

These committees significantly shaped corporate governance reforms in India, influencing SEBI's regulations and Clause 49 of the Listing Agreement.

## **KOTAK COMMITTEE ON CORPORATE GOVERNANCE – MAJOR RECOMMENDATIONS**

The **Kotak Committee on Corporate Governance (2017)**, led by **Uday Kotak**, was formed by SEBI to enhance transparency and strengthen governance practices in Indian companies. The committee made **81 recommendations**, out of which SEBI accepted **40** recommendations as it is, **15** recommendations with certain modifications, **18** recommendations were rejected and **8** recommendations were suggested to other regulatory bodies. SEBI thereafter, amended the SEBI (LODR) Regulations, 2015 to incorporate the suggested changes,

**1. Audit / Audit Committee**-Enhanced Role of Audit Committee. Audit Committees should review **utilization of funds** (whether in the form of advances or investment or loans) **and related-party transactions**.

### **2. Boards**

- **Board Size** – At least 6 directors on the Board of the listed companies to ensure varied expertise.
- **Gender Diversity**- Listed companies should have at least one independent woman director on the Board to promote inclusivity.

### **3. CEO / CFO**

- **Separation of CEO & Chairperson Roles** – Recommended that **listed companies separate the roles of CEO and Chairperson** to improve oversight.

### **4. Directors**

- **Expansion of eligibility criteria for independent directors**- Exclude “promoter group’ and “board interlocks’ from becoming independent directors .
- **Higher Independence in Board Committees** – Nomination & Remuneration Committees and Risk Management Committees must have a majority of independent directors.
- **Enhanced role of different committees of directors like- NRC, SRC,RMC. These committees must meet at least once a year.**
- **Director expertise matrix**-Board to determine a chart or matrix having core skills, expertise and competencies which directors are required to possess and which the directors actually possess, in the corporate governance section of the annual report.

**5. Establishment of Risk Framework or Internal Controls**- Recommended forming a **dedicated risk management committee** for effective risk oversight. RMC to review cyber security.

**6. Financial Disclosures**- **Enhanced disclosure of related party transactions**. Mandatory **disclosure of auditor credentials, audit fees, and reasons for resignation of auditors**.

**7. Others**- Strengthened the **whistleblower mechanism** to ensure protection for individuals reporting governance lapses. Mandatory Secretarial Audit for listed entities. Removing the boundaries of physical meetings and adopting the use of technology.

## IMPORTANT PROVISIONS OF COMPANIES ACT, 2013 on CORPORATE GOVERNANCE

After the 'Satyam scandal' which happened to be the largest accounting fraud in history of corporate India- the regulators and Government took measures to improve the corporate governance standards in India. The most important regulation through which the Government tried to plug loopholes is the Companies Act, 2013 wherein several provisions relating to independent directors, accountability of auditors, additional financial disclosures, shareholders activism etc were introduced. Some of the important provisions in this regard are-

### 1. Auditors

- Compulsory rotation of auditors and audit firm. An individual auditor cannot be appointed for more than **1 term of 5 consecutive years**. An audit firm\LLP cannot be appointed as auditor for more than **2 terms of 5 consecutive years each. (Sec.139)**
- Incoming auditor not to be associated with outgoing auditor through common partners. **An audit firm connected with the previous audit firm via a common partner, shall not be eligible** for appointment in that company.
- Internal audit, Joint audit and Internal rotation. Under Sec.139(3), the auditing partner & his team may be rotated at specified intervals (i.e. **internal rotation**) or that audit be conducted by more than one auditor (i.e. **joint audit**). Under Sec.138., Internal audit made compulsory for prescribed companies.
- Auditor cannot perform non-audit services (like accounting, bookkeeping, management services, actuarial services etc.) for the client company. (Sec.144)

### 2. Board

- Maximum strength of Board fixed at 15, which can be increased only after shareholders' approval through special resolution in the general meeting. Sec.149(1)
- To have inclusivity and diversity, the Boards to have at least one women director, a resident director, independent directors, small shareholders director (Sec. 151), etc.
- At least one third of Board of a listed public company shall consist of independent directors. (149)
- Board Committees like-Audit Committee, and Nomination and Remuneration Committee, CSR committee to have independent director as members.

### 3. Corporate Social Responsibility

- Spending for CSR activities is now mandatory for prescribed companies.(Sec.135)
- Companies having Net Worth  $\geq$  Rs. 500 crore or Turnover  $\geq$  Rs.1000 crore or Net Profit  $\geq$  Rs. 5 crore during any financial year shall constitute a CSR committee for formulating and monitoring the CSR policy.
- During the financial year, such companies are required to spend on CSR activities at least 2% of the average net profits of immediately preceding three years.
- Activities /Expenditures eligible for CSR activities have also been specified in Schedule VII of the Companies Act, 2013. These include activities for the benefit of **Armed forces and war widows, Backward groups and senior citizens, Conservation of nature and environment, Development of rural areas and slums, Education and vocational training, Funding in PM National Relief Fund and PM CARES Fund, Gender equality and women empowerment, Health care and sanitation, Innovation and Research etc.**

#### 4. Directors

- **Duties of directors** have been defined in Sec.166 of the Act to fix their responsibility.
- **Directors' Responsibility Statement:** Directors to include a responsibility statement in the board report covering their responsibility with respect to compliance with accounting standards, the maintenance of adequate accounting records, and the implementation of effective internal control systems.
- Independent Director can be appointed for a maximum of two terms of five years each and then after cooling period of three years, can be reappointed.
- Independent Directors to be liable for acts which have occurred with his prior knowledge or where he has not acted diligently.

#### 5. E-governance

- Maintenance of records (such as accounts, vouchers, minutes, registers etc.), servicing of documents( such as notices of General Meetings to shareholders or notices of Board meetings to directors or company documents to concerned officials and ROC) , and payments ( dividends to shareholders or fees to ROC) to be in electronic form.
- E -voting was made mandatory for listed companies or companies having 1000 or more shareholders
- Board Meetings through video -conferencing or other audio-visual means allowed.
- Certain information like CSR Policy, Financial statements, Auditors' Report etc. to be placed on the website of the company.

#### 6. Financial Disclosures

- **Financial Reporting:** Companies are required to file an Annual Return and Financial Statements with the Registrar of Companies every year.
- **Additional disclosure requirements** These documents must include detailed information about the company's financial performance, board composition, shareholding patterns, executive remuneration, corporate structure, governance practices, risk profile of the company etc.
- **Related Party Transactions:** The Act imposes strict regulations on related party transactions to prevent conflicts of interest and ensure that such transactions are conducted in the company's best interests. Companies must disclose these transactions in their financial statements.
- **Disclosure of Promoters' Holdings:** Listed company shall file a Return with the Registrar in case of any change in the number of shares held by promoters and top 10 shareholders within 15 days of such change.

#### 7. Others

- **Shareholders Activism-** Greater shareholder involvement in corporate governance through initiatives such as electronic voting, approval or disapproval of related party transactions, appointment of small shareholders director, Stakeholders Relationship Committee etc.
- **Vigil Mechanism-** Companies to establish vigil mechanism for directors and employees to report unethical practices and genuine concerns. (sec.177). Audit Committee or BODs to oversee the vigil mechanism and ensure that persons reporting the issue can directly access them and are not victimised or harassed.

- **Serious Fraud Investigating Office (Sec.211)**- The Act establishes the SFIO, a specialized agency, responsible for investigating serious cases of corporate fraud. The SFIO has the power to hold investigations, file investigation report with the Court, make arrests and bring legal action against those involved in fraudulent activities.
- **Class Action Suits** -Sec.245 of the Act, empowers the shareholders, members or depositors of a company to file a class action suit if the company's affairs are being conducted in a manner prejudicial to their interests. Further expenses incurred for class action suits can be reimbursed out of Investor Education and Protection Fund.

These provisions collectively work towards improving the standard of corporate governance in India by promoting transparency, accountability, and ethical conduct within companies.

## **SEBI (Listing Obligations and Disclosure Requirements) Regulations,2015**

Till the promulgation of SEBI (Listing Obligations and Disclosure Requirements) Regulations,2015, a listed entity used to be governed by the Listing Agreement executed by it with the stock exchange. Clause 49 of the Listing Agreement contained provisions on corporate governance which it was required to comply with. On September 2, 2015, SEBI (LODR) Regulations,2015, were notified and it replaced all listing Agreements. These regulations were amended in year2016, 2017, 2018 and 2024. Amendments in 2018 were made in the light of recommendations of Kotak Committee on corporate governance. These regulations apply to an entity listed on a recognised stock exchange. Major requirements having bearing on corporate governance are provided in Regulations 17 to 27.

### **BOARD OF DIRECTORS**

- **Composition of Board of Directors**
  - ✓ BoD of a company shall have an optimum combination of executive and non-executive directors. Where the chairperson of the Board is a non-executive director, atleast 1/3 of Board shall comprise of independent directors and where the chairperson of Board is an executive director , at least 50% of the board shall comprise of independent directors
  - ✓ BoDs of the top 2000 listed entities shall comprise of not less than 6 directors.
- **Diversity in Board of Directors**
  - ✓ BoD of a company shall have at least one woman director.
  - ✓ Boards of the top 1000 listed entities shall have at least one independent woman director.
- **Restrictions on directorships**
  - ✓ A person shall not be a director or independent director in more than 7 listed entities.
  - ✓ A person who has attained the age of 75 years cannot be appointed or continued as a non-executive director unless passed by a special resolution and properly justified.
- **Frequency of Board meetings**
  - ✓ The board of directors shall meet at least 4 times a year,
  - ✓ Maximum time gap can be of 120 days between two consecutive board meetings.
- **Quorum of Board meetings**
  - ✓ The quorum for Board meetings of the top 2000 listed entities shall be 1/3 of its total strength or three directors, whichever is higher, including atleast 1 independent director.
  - ✓ Participation of directors by video conferencing or other audio-visual means shall be counted for the purposes of quorum.
- **Skill/ Expertise Matrix** – BODs to disclose a chart or matrix of core skills, expertise and competencies which are required to be possessed by the members of the board and the ones which the members actually possess, without disclosing the names of the directors.
- **Succession Planning**-BODs shall ensure that plans are in place for orderly succession for appointment to the board and senior management.
- **Risk Assessment**- BoDs shall be responsible for framing, implementing and monitoring the risk management plan for the listed entity.
- **Compliance Reviews**- BoDs shall periodically review compliance reports pertaining to all laws applicable to the listed entity as well as steps taken by the entity to rectify instances of non-compliances.
- **Code of Conduct**- BoDs to lay down a code of **conduct** for all members of the board and senior management of the entity.

## INDEPENDENT DIRECTOR

- **Stringent definition of Independent Director**
  - ✓ They must meet the criteria of independence outlined under Regulation 16 of LODR, which includes not being promoter or related to promoter, having no material or pecuniary relationship with the company and not being a key managerial person for at least three years prior.
  - ✓ Independent directors to submit a declaration stating that they meet the criteria of independence as specified in Regulation 16, the **veracity of this Declaration of Independence to be confirmed by the Board.**
  - ✓ While the Companies Act generally applies a two-year cooling-off period under different criteria of independence, SEBI (LODR) Regulations impose a **stricter three-year restriction.**
  - ✓ An independent director **cannot be less than 21 years** of age
  - ✓ A **member of the promoter group cannot be** an independent director
  - ✓ A person who is part of **'board- interlocks'** **not** to be considered independent director.
- **Procedure** -A listed entity is required to pass special resolution for appointment, re-appointment or removal of an Independent Director.
- **Tenure** -The maximum tenure of independent directors shall be in accordance with the Companies Act, 2013. This implies that they can be appointed for a term upto 5 years and can be reappointed for another term of 5 years subject to shareholders approval. After 2 terms, they must take a cooling -off period of three years before being eligible for reappointment. The recommendation of Nomination and Remuneration Committee and their performance evaluation shall be considered for reappointment.
- **Familiarisation**-The listed entity shall familiarise the independent directors through various programmes about the listed entity , its business model, nature of its industry etc.
- **Vacancy**- An independent director who resigns or is removed from the board shall be replaced by a new independent director at the earliest but not later than immediate next board meeting or 3 months whichever is later.
- **Directorships** -A person shall not serve as an independent director in more than seven listed entities. If any person is serving as a wholetime director in any listed entity, he shall serve as an Independent Director in not more than three listed entities.
- **Separate Meetings** -The Independent Directors must hold at least one meeting per year, without the presence of non-independent directors, to review the performance of board, quality of information flow and company's overall performance. All the independent directors must strive to be present at such meeting.
- **Remuneration**-Remuneration paid to Independent Directors must be approved by shareholders and should not include any stock options. They can however, receive sitting fees, reimbursement of expenses and profit -linked commissions.
- **Liability**- An independent director shall be liable, only in respect of such acts of omission and commission by the company which had occurred with his knowledge/ consent/connivance or where he had not acted diligently.
- **Performance Evaluation** -The performance of Independent Directors must be evaluated by the entire board, excluding the director being evaluated.

## **COMMITTEES OF THE BOARD**

### **AUDIT COMMITTEE**

- ✓ Every listed entity shall constitute an audit committee comprising minimum three directors as members, two-thirds of whom shall be independent directors.
- ✓ All the members of audit committee shall be financially literate and at least one member shall have accounting or financial expertise.
- ✓ The chairperson of the Audit Committee shall be an independent director and he shall be present at the Annual General Meeting to answer shareholder queries.
- ✓ The Audit Committee shall meet atleast 4 times in a financial year and not more than 120 days shall elapse between two consecutive meetings.
- ✓ The quorum for Audit Committee shall be two members or one third members of the audit committee, whichever is greater, with at least two independent directors.
- ✓ The Audit Committee shall have powers to investigate any activity within its terms of reference, seek information from any employee or obtain outside legal or professional advice. It shall specifically review the utilisation of funds raised through public offers.

### **NOMINATION AND REMUNERATION COMMITTEE (NRC)**

- ✓ The NRC shall be composed of minimum three members out of which at least two-third directors shall be independent directors.
- ✓ All the members of Nomination and Remuneration Committee shall be non-executive directors.
- ✓ The chairperson of the Nomination and Remuneration Committee shall be an independent director and he *may* be present at the Annual General Meeting to answer shareholder queries.
- ✓ NRC shall meet at least once a financial year.
- ✓ The quorum for Nomination and Remuneration Committee shall be two members or one third members of the committee, whichever is greater, with atleast one independent director.
- ✓ The NRC shall recommend remuneration policy to the Board, recommend appointment/removal of directors and KMPs, and formulate performance evaluation criteria.

### **STAKEHOLDERS RELATIONSHIP COMMITTEE(SRC)**

- ✓ SRC shall comprise of at least three directors, with at least one being an independent director
- ✓ The chairperson of this committee shall be a non-executive director.
- ✓ The Chairperson of the Stakeholders Relationship Committee shall be present at the annual general meetings to answer queries of the security holders.
- ✓ The Stakeholders Relationship Committee shall meet at least once a financial year
- ✓ The listed entity shall constitute a Stakeholders Relationship Committee to specifically look into the interests of shareholders, debenture holders and other security holders and for redressal of their grievances.

### **RISK MANAGEMENT COMMITTEE (RMC)**

- ✓ The Board of directors shall constitute a Risk Management Committee which shall have minimum three members, including at least one independent director.
- ✓ The majority of members in the Risk Management Committee shall consist of board members.
- ✓ The Chairperson of the Risk Management Committee shall be a member of the board of directors and senior executives of the listed entity may become members of the committee.
- ✓ The risk management committee shall meet at least twice in a financial year and not more than 210 days shall elapse between any two consecutive meetings.

- ✓ The quorum for a meeting of the Risk Management Committee shall be either two members or one third of the members of the committee, whichever is higher, including at least one board member.
- ✓ They shall formulate risk management framework, identify and assess risks, oversee the implementation of risk mitigation measures and specifically look into the cyber security issue.
- ✓ This provision shall be applicable to the top 1000 listed entities and they shall confirm in their Compliance Report on Corporate Governance whether they have complied with RMC requirements.

#### **VIGIL MECHANISM**

- ✓ The listed entity shall formulate a vigil mechanism/whistle blower policy for directors and employees to report genuine concerns.
- ✓ The vigil mechanism shall provide for adequate safeguards against victimization of the whistleblower
- ✓ It shall provide for direct access to the chairperson of the audit committee in appropriate or exceptional cases.

#### **RELATED PARTY TRANSACTIONS**

- ✓ The listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions.
- ✓ All related party transactions shall require prior approval of only independent directors on the audit committee of the listed entity. All 'material' related party transactions shall require prior approval of the shareholders through resolution.
- ✓ The listed entity shall submit to the stock exchanges disclosures of related party transactions in the prescribed format and publish the same on its website.

#### **DISCLOSURES ON THE WEBSITE**

- ✓ Listed entity shall maintain a functional website containing the basic information about the listed entity.
- ✓ The website shall disseminate information on matters such as- terms and conditions of appointment of independent directors; composition of various committees of board; Code of Conduct of directors and senior management; vigil mechanism / whistle-blower policy; policy on related party transactions etc.
- ✓ Credit Rating obtained by a listed entity for its outstanding instruments to be disclosed on its website.

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