‘COMMENTARAO’ IN “THE TELEGRAPH”
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“Positive signals

- Corporate governance under the new Companies A**Corporate Governance under the new Companies Act” by**
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The Irani Committee reported ten years ago on the then proposed amendments to the Companies Act. The amended Act is now in force. Annual Reports obeying the changes, will be out soon for the year ended in March 3015. Government is appointing a Committee to study the issues arising from the new Act. There are issues in

Implementation, some gaps, but the Act wass a good step forward.

The Act continues with the earlier practice of the SEBI

rules being more stringent for listed companies as

compared to others. Instead of two different sets of

regulations, the SEBI requirements should be included in the Companies Act. For example, the provisions of Clause 49 of the Listing Agreement, and of the Companies Act, 2013, are different for approval of related party transactions. They should be made identical.

The Act does not lay down specific rules for private limited companies as it did before. The rules are common to both, the only variable making a difference being stipulated sizes of companies. Beyond a given size of private company,

provisions relating to independent directors, women directors, CSR, Nominations Committee duties, Audit Committee responsibilities, etc, may also apply to private limited companies.

Separate laws exist today for large businesses that remain sole proprietorships or partnerships. Similarly, many trusts and charitable societies are regulated by separate laws and institutions. In many cases these bodies do not file accounts in time, do not make required disclosures, avoid/evade tax, and indulge in other violations. The stringent disclosure requirements of the Companies Act and its relatively superior regulation, might improve the situation. The Companies Act might be made applicable to all these other bodies as well, beyond a certain size.

The Irani committee enunciated the principle that corporate governance goes far beyond “access to capital”. The new Companies Act in fact lays down rules for corporate governance that go beyond finances. What the Act has omitted to do is to bring in rules as in Chapter 11 of the USA Bankruptcy Code. Enabling filing for bankruptcy to give time for rehabilitation under stringent rules, is a good idea. It is an option that enables the debtor company a fresh start, subject to the debtor's fulfillment of its obligations under its plan of reorganization. Companies in Chapter 11 are monitored strictly in the USA. It certainly is a superior alternative to the BIFR and its successor which takes over a 'sick' company and uses government officials to run it. There is no mechanism to give a company breathing space to reform itself.

One would have preferred that companies were permitted to file half-yearly results instead of quarterly ones as required by the listing agreement with SEBI. This is another reason for wanting SEBI rules for listed companies to be a part of the Companies Act. In the USA the declaration of quarterly results puts pressure on boards to show growth each quarter which may not always be in the company's interest. In India there is the further complication cause by the rule of the Institute of Chartered Accountants that notional gains and losses on foreign exchange fluctuations must now be included in the accounts each quarter.

The Act now permits board meetings through video conferencing. In practice, many companies have avoided video conferencing in Board meetings because the Act also requires such meetings to be recorded. This could constrain free and frank expression of opinions, an essential before a consensus decision is arrived at. Instead the law should have required minutes to be prepared and approved by all participants as it is for physical meetings.

There should also have been a limit on the size of Boards so that the size does not make it a circus. There are no restrictions placed on age of directors in the Act. It would have been wise to place an upper limit and accept only those who are certified as mentally capable.

One feature in the new Act that must be commended is the limit on the service period for independent directors to two terms of five years each. This assures stability for the directors and the companies. Some directors may have been nervous about losing fees if they are dropped suddenly. They can now take courage that they have at least one five year term and cannot be sacked in between except under extreme circumstances. At the same time it might be sensible to place a physical Rupee upper limit (instead of a percentage of net profits at present) irrespective of the size of the company, to the total remuneration paid including commissions, to independent directors. There should also be a bar on giving them stock options. These measures could avoid income expectations ruling the minds of independent directors on company boards.

The Act gives a great deal more powers to the Nominations and Remunerations Committee. In the past in most companies this Committee has been a rubber stamp of the controlling interests. Under the new Act, it cannot be so any more since the committee has to evaluate all directors every year and state the criteria in the Annual Report. (I would have preferred it if the evaluation criteria were handed over to a neutral third party who could evaluate, identify non-performers, offer counseling for their improvement). This provision will take time to have

effect since directors might be over-sensitive to fraternal evaluations. Evaluation of the board functioning by independent directors is also laid down, an excellent idea. This must be discussed with the full Board so that there can be improvement.

Another development now is the identification of the best talent in the Company for promotion to directors, and their regular evaluation by the independent directors. This requirement in many companies has yet to take effect. Its value is undisputable.

Provisions for reporting transactions between related parties and the company are not new. What is new

however is the requirement of prior approval of the Audit Committee, Board, and shareholders. Prior shareholder approval poses practical difficulties if it is to be honestly implemented.

An excellent provision is for risk assessment and reporting. However it might have been better if the Act expected Directors to devote ample time at least once a year to discuss risks in detail and decide the strategies and actions for mitigation, and find opportunities in them. At present it is practically an exercise performed by management and little participation by directors.

Corporate social responsibility has now to receive 2% of net profits of certain size of companies. While the spending is not compulsory, it has to be reported in the Annual Report. Well-run companies would prefer not to be the ones that did not spend on CSR. However, the planning and execution of this expenditure from company profits demands much more active participation by directors than provided in the law and in practice.

Other new provisions to be commended are of reasonably long terms for auditors before they have to be changed and the appointment of at least one woman director. While there is no compulsion that the appointee be independent, this is a good beginning to bring about more gender balance in corporate governance.

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