

Opportunities for CAs as an Independent Directors to enhance the credibility and governance standards of the corporate world



By



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Author of more than 300 books & Global business, professional growth and motivational coach
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Member IFAC-PAIB committee 2001-2004; Member IFRS SMEIG London 2018-2020

Ex-director - SBI mutual fund, BOI mutual fund, global mediator and international arbitrator
B. Com (Hons), M.Com, FCA, FCS, FCMA, LL.B, LLM(Constitution),Dip CG, MBA, Dip IFRS (UK), DLL&LW, Dip IPR, Dip in Criminology, Ph. D, Mediation ,IP(IBBI), MBF, Dip HRM, Dip Cyber Law

20+ Certificate courses; 75+ Self Development Courses

Student of: MA (Psychology), MA (Economics), PGD CSR, PGD Crime Investigation IBBI (RV)

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Ranks ALL INDIA 1st in Inter CA; 6th in CA Final; 3rd in CMA Final, 5th in Mumbai University +++

Chairman western region ICAI 1997; Council Member ICAI 1998-2016

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Introduction:

The concept of Independent Directors is a welcome step for corporate governance in India. Independent directors are expected to use their capacity, knowledge and resources towards maximization of stakeholder's value and well being. They ensure progress of mankind through transparency, accountability and truthful disclosure of state of affairs of company. The Companies Act, 2013 has conferred greater empowerment upon Independent Director's to ensure that the management and affairs of a company is being run fairly and smoothly..

Corporate governance would mean to steer an organization in the desired direction. The need for corporate governance emerge in amidst the corporate misdeeds, that have shattered the confidence of investor. Therefore, the framework is primarily motivated in boosting the loss of confidence thereby restoring their faith. The economic liberalisation in the early 90's that have lead to the significant growth of corporate world, simultaneously lead to the rise of malpractice, frauds, scam not to mention that corporate governance was itself establish to combat the practice of frauds affecting the corporate and securities market.

This concept of corporate governance has been described as:

1. process of governing the corporation or giving direction for its framework

2. It sort of provides the company compliance for the purpose for encouragement of the working to be in the framework of guidelines/content of compliance
3. Study of economic fields providing separation management and ownership
4. Guide to investment technique

In nutshell the corporate governance is more of a mechanism than a provision of law. In simple term one can define corporate governance as

- a set of principles that help the company to be governed, and holds the concept of transparency, accountability & responsibility, healthy process that results in business prosperity

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.

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.

Few 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.
- Responsibility to act in the larger interest of true growth and development of the company

The Companies Act 2013, contains various new provisions for better governance of the companies. Some of the 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.

Director is generally a person who is incharge with managing the affairs of the company/corporation. The term director is defined under the Company Act, 2013 under section 2 (34) meaning a director who is appointed to the Board of a company. Moreover it should be noted that directors are treated as the officers rather than employee. The definition of Officer provided under section 2 (59) of the Act, is reiterated below

Section 2 (59) –officer includes any director, manager or key managerial personnel or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act.

The Supreme Court of India have time and again affirmed the prime importance of Directors for instance in *Bajaj Auto Ltd v. N.K. Firodia* (1971) 41 Comp Cas 1 it was held that the Directors holds a fiduciary position with both company and stakeholder since they have to act in paramount interest of company and general interest of stakeholder. Lastly it concluded that such officers are trustees for the company as whole and not just for the shareholders.

Since it is well established that a company though having identity of its own is only an artificial person, therefore it is not possible for it to work/act on its own which why it needs the engagement of persons who will responsible for its affairs. As explained above a directors are that officer who is entrusted with managing the affairs of the company who collectively known as the Board of Directors/Board.

The Board of Director is consists of Executive Directors and Non-executive Directors wherein the former one are entrusted with the work of looking of routine operation/management of the company and later are specially appointed for the safeguarding the interest of the company. It is to be noted that the Executive Directors are considered as the senior level staff of the corporation whereas the Non-Executive Directors are more of the guardian thereby doesn't possess the managing responsibilities of the corporation.

Interestingly the post of Executive Director despite being the common post in every organisation/corporation has not defined in the Companies Act, 2013 nor its predecessor the Act of 1956. Section 2 (54) of the Companies Act, 2013 defines the term Managing Director as

“A director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called”

Therefore, the Managing Director received and exercise the power of management of the affairs of the company only under the articles of a company/ an agreement with company/ resolution passed in general meeting/ Board and not otherwise.

The non-executive directors is the post completely opposite to the Executive directors since there task/duties towards corporation has nothing to do with day to day affairs of the same. The prior reason for appointing a non-executive director to the company’s board is their independence from the company’s management and other stakeholders. Hence, they bring objectivity, unbiasedness, calibre and other qualities to the board. An independent director is a non-executive director who is independent and having no business or other relationship with company so as to interfere directly or indirectly with his independent and objective judgment.

Therefore, one can rightly assert that such Independent director of the company are those who assist the company in enhancing the credibility and governance standards of the corporate.

The term Independent Director has been defined under section 149 (6) of the Companies Act, 2013. The said section is reiterated as below:

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 nonprofit 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

The subsection (8) of section 149 also states that Independent Directors are abie by the provision of Schedule IV of the Companies Act, 2013. The said schedule provide the code for Independent Directors. The whole edifice of good corporate governance is dependent on efficacy and effectiveness of independent directors. Independent Directors are considered as mentors of management and as supervisor who will ensure that management action

creates value to shareholders, responsible for protecting minority shareholders' interests as well

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.

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.

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.

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 behavior, actual or suspected fraud or violation of the company's code of conduct or ethics policy;
 - (12) [act within their 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

Conclusion:

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.

There are several distinct benefits that an independent board of directors can bring to a company, the first and foremost is that the internal processes that are can be controlled, and the mismanagement or fraud which is being done by the company can be brought to the knowledge of the shareholders of the company and to the public at large. It has some other benefits also, which include

- Offset the management flaws in a company.

- Ensure the practice of legal and ethical behavior at the company, and at the same time strengthening accounting controls.
- Increase the popularity of the company through his contacts and expertise so as to strengthen the share capital of the company.
- Be a part of long-term decisions which need to be taken, for the welfare of the company.
- Help a company survive, grow, and prosper over time through improved succession planning through membership in the nomination committee

Few websites to refer

- www.sebi.gov.in – Securities and Exchange Board of India
- www.mca.gov.in – Ministry of Corporate Affairs, Government of India
- www.dpe.nic.in - Department of Public Enterprises www.rbi.org.in – Reserve Bank of India
- <https://www.independentdirectorsdatabank.in/> - Data bank