New Board Dynamics
Composition, roles, responsibilities of the board under the Companies Act, 2013

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New Board Dynamics
The centrality of boards

The boards are central to the governance of companies and their basic governance responsibilities remain more or less the same across the world. As trustees of the shareholders, the boards play a key role in providing direction to the companies in terms of approving the strategy, maintaining their integrity, enhancing their performance and ensuring that the companies operate in the best interests of the shareholders and other stakeholders. Given the complexity of today's corporate structures and rapid changes that are occurring in the economy and the market, this is no mean task.

Adding to these complexities are the heightened expectations of the shareholders and the enhanced regulatory requirements that demand more accountability and transparency - all of which are creating new challenges for the boards. Boards need to be aware of these emergent challenges and frame the right policies, put in place and implement the right processes and practices with the active support of the management so that collectively they can stand up to increased scrutiny of shareholders and various other stakeholders and of the regulators.

The Companies Act, 2013 (New Act) has raised the bar for the boards in India. The New Act has made several significant changes, which seek to redefine the board governance in India. New concepts have been introduced such as women directors on the boards to bring in gender diversity, small shareholder director, performance evaluation, corporate social responsibility and class actions; the internal financial controls and risk management oversight of the boards have been strongly emphasised; disclosures have been enhanced in board's report to shareholders, additional rigour has been added to strengthen the Directors' Responsibility Statement; and the Independent Directors have been entrusted with new responsibilities to make their role more objective and purposeful. Overall, the New Act aims to raise the governance profile of Indian companies and their boards, at par with the roles and responsibilities assumed by boards globally. We summarise the important new provisions of the New Act, which relate to the boards.

Composition, Roles, Responsibilities of the Board Under the New Act

Overview of the key additional provisions

New provisions applicable to the boards of all companies, including the listed companies

Additional disclosures in the annual return filed by the companies

Section 92:

- Every company is required to prepare an annual return containing the particulars as at the close of the financial year relating to, among other things, details of principal business activities, particulars of holding, subsidiary and associate companies, details of promoters, directors, key management personnel, meetings of board and its various committees along with attendance details, remuneration of directors and key management personnel and penalties or punishment imposed on directors
- An extract of the annual return to form a part of the board's report

Additional disclosures in the board's report

Section 134 (3)

The board report to shareholders to now additionally include:

- the extract of annual return (as required in Section 92 (3)), meetings of the board, Directors' Responsibility Statement, declaration by Independent Directors (as required in Section149 (6)), company's policy on director appointment and remuneration including criteria for qualifications, positive attributes independence, comments on adverse remarks in auditors report and in the secretarial audit, particulars of loans, guarantees or investments (as required in Section 186), related party transactions, state of company affairs, reserves, dividends to be paid, material changes in financial positions between the end of the financial year and the date of the report, energy conservation, foreign exchange earnings and outgo, statements on development and implementation of policies for risk management and corporate social responsibility and a statement on the manner of formal evaluation of performance of the board, its committees and individual directors for listed and public companies

Additional disclosure in the Directors' Responsibility Statement regarding internal financial controls and regulatory compliance

Section 134 (5)

- The Directors' Responsibility Statement to now additionally state that the directors had devised proper systems for internal financial controls and for ensuring compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively

Constitution of a new board committee for Corporate Social Responsibility

Section 135

- Every company having net worth of rupees 500 crore or more, or turnover of rupees 1000 crore or more or a net profit of rupees 5 crore or more during any financial year to constitute a Corporate Social Responsibility (CSR) Committee of the board. The board to approve the CSR policy of the company and ensure that in every financial year, the company spends at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its CSR policy
- The CSR committee to formulate the CSR policy and the board to approve the policy and place it in the company's web site
- The CSR committee to have at least one Independent Director
- Board's report to contain the composition and the policy as well as reasons for failure to spend the prescribed amount of two percent

Composition of the board

Section 135

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Section 149 (1)
- The board to have a minimum of three directors for a public company and two for a private company and a maximum of 15 directors
- It should have at least one woman director. Listed companies to appoint such director within one year of commencement of the New Act and other companies with paid–up share capital of one hundred crore rupees or more – within five years from the commencement

Fiduciary duties of directors
Section 166
- For the first time the New Act enlists the specific fiduciary duties of a director:
- to act in accordance with the articles of the company
- to act in good faith to promote the objects of the company for the benefit of its members as a whole
- to exercise his duties with due and reasonable care, skill and diligence, and independent judgment
- not to be involved in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company
- not to achieve or attempt to achieve any undue gain or advantage
- not to assign his office

Board meetings through video-conferencing or other audio visual mode permitted
Section 173
- The minimum number of board meetings to be four annually
- The period between two consecutive meetings of the board to be not more than 120 days
- Participation in board meetings permitted through video-conferencing or other audio-video means which are capable of recording and storing of the proceedings of the meetings, provided that matters of approval of annual financial statements and approval of board's report are not dealt with any meeting held through such means

Appointment of whole-time key management personnel through a board resolution
Section 203 (2)
- The New Act defines the whole-time key managerial personnel of a company as the managing director or Chief Executive Officer or manager or in their absence a whole-time director, company secretary, Chief Financial Officer
- Whole-time key managerial personnel to be appointed by means of a board resolution containing the terms and conditions of the appointment including the remuneration
- Whole-time key managerial personnel not to hold office in more than one company simultaneously except in case of a subsidiary
- Vacancy for whole-time key managerial personnel to be filled within six months
- Contravention of the provisions attracts civil penalty for the company as well as the director and key managerial personnel in default

New additional provisions for listed companies

For listed companies, additional disclosure in the Directors' Responsibility Statement on internal financial controls

Section 134 (5)

- The Directors' Responsibility Statement to state additionally that that the directors, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively

The board of a listed company to include Independent Directors

Section 149(4)

- Listed companies to have at least one third of the total number of directors as Independent Directors

Independence defined

Section 149(6)

- Independent Director must, among other things, be a person of integrity, possess expertise and experience, not be a promoter of the company or the holding or associate company, not be related to the promoter or directors of the company, or the holding or subsidiary or associate company, whose relatives not have any pecuniary relationship or transaction with the company or the holding or associate company and neither he nor any of his relatives hold any key managerial position in the company or the holding or associate company

Declaration to be given by the Independent Director

Section 149(7)

- Every Independent Director to give a declaration that he meets the criteria of independence, 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

Entitlements of Independent Directors

Section 149 (9)

- Independent Directors may receive fees, reimbursement of expenses and profit related commission as approved by the members but will not be entitled to any stock option

Tenure of Independent Directors

Section 149 (10), (11)

An Independent Director

- can hold office for a term up to five consecutive years
- is eligible for reappointment for a second term on passing a special board resolution
- cannot hold office for more than two consecutive terms
- would be eligible for appointment after three years of ceasing to be an Independent Director
- but cannot be associated with the company during this three year period in any capacity
- provisions of retirement under sections 152 (6) and (7) not applicable to Independent Directors

Liability of Independent Director

Section 149 (12)

- An Independent Director would be liable for such acts of omission or commission by a company which has occurred with his knowledge and attributable through board processes and with his consent and connivance or where he has not acted diligently

Selection of Independent Director

Section 150

- An Independent Director may be selected from a data bank maintained by any institution as notified by the central government
- The company to do the necessary due diligence before selecting the director
- Appointment of an Independent Director to be approved by the company in a general body meeting
- The manner and procedure of selection of an Independent Director to be prescribed the central government

Small shareholder director for a listed company

Section 151

- A listed company to have one director elected by the small shareholders who are defined as those shareholders who have a shareholding of nominal value rupees twenty thousand

Board to appoint Audit Committee

Section 177 (1) & (8)

- The board to constitute an Audit Committee
- The terms of reference of the Audit Committee to specified in writing by the board
- Board's report to disclose the composition of an Audit Committee
- Board's report to disclose where the board had not accepted any recommendation of the Audit Committee, along with the reasons for not accepting the recommendations

Board to appoint Nomination and Remuneration Committee

Section 178 (1) & (4)

- The board to constitute the Nomination and Remuneration Committee
- The committee to comprise three or more non-executive directors out of which not less than one-half shall be Independent Directors
- Chairperson of the company not to be the chairperson of the committee
- The policies of the committee relating to the remuneration for the directors, key managerial personnel and other employees to be disclosed in the board's report

Board to appoint Stakeholders Relationship Committee

Section 178 (5)

- The board of a company which consists of more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year to constitute a Stakeholders Relationship Committee consisting of a chairperson who shall be a non-executive director and other members as decided by the board

Board to annex the Secretarial Audit report to the board's report

Section 204 (1) & (3)

- A secretarial audit report, given by a company secretary in practice, to be annexed with the board's report
- The board to explain in the board's report any qualification or observation or other remarks made by the company secretary in the secretarial audit report

Implication of the new provisions for the Boards and the Management

The New Act casts additional responsibilities on the boards of all companies. For the listed companies the additional responsibilities are more. The boards will have to determine the ways and lay down appropriate systems and procedures to fulfil these responsibilities. These responsibilities would in turn translate into the responsibilities of the management, which would have to assist the boards to fulfil them. We enlist below what some of these key additional responsibilities mean for the boards.

Scale: Significant Substantial Considerable Marginal

Provisions	What it means for the Boards and the Management	Effect on Timeshare of Boards
Additional disclosures in the Directors' Responsibility Statement by all companies	• The boards would now have to articulate their policy on directors' appointment and remuneration • The boards would have to explain if there are any qualifications in the secretarial audit report • The boards would have to lay down its policies for regulatory compliance and risk management and ensure these are operating effectively • The boards would have to devise proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively • The boards have to make annual assessment of the internal financial controls and may consider getting an independent expert assurance on such systems • The boards would have to lay down the manner of formal evaluation of performance of the board, its committees and individual directors for listed and public companies	Significant increase in the board's time
Reconstitution of the board and reconstitution of its committees	• The board would now have to select a woman director • The boards of listed companies to have one elected director to represent small shareholders as defined by the New Act • The boards of listed companies would have to have at least one third members as independent as defined by the New Act • Three new committees – the Nomination and Remuneration Committee, the Stakeholders Relationship Committee and the Corporate Social Responsibility Committee, have to be additionally appointed over and above the Audit Committee • The boards may have to select new Independent Directors for the additional committees to be set up and ensure that the existing Independent Directors meet the eligibility criteria under the New Act, especially in view of the additional restrictions imposed on the tenure	Considerable increase in the board's time
Corporate Social Responsibility Committee	• The boards would now have to lay down its policy on CSR, constitute a Committee and give reasons if the company has not been able to spend the mandatory amount	Considerable increase in the board's time
Boards to define terms of reference for the Audit Committee	• The boards of listed companies and other classes of companies prescribed by the Rules would be required to specify in writing the terms of reference for the Audit Committee - something that they were not required to do earlier	Marginal increase in the board's time

Provisions	What it means for the Boards and the Management	Effect on Timeshare of Boards
Nomination and Remuneration Committee	• The Committee would have to set out the policies relating to the remuneration for the directors, key managerial personnel and other employees and recommend to the board and disclose them in the board's report • The Committee would also have to develop the criteria to carry out evaluation of every director's performance and accordingly recommend to the board each director's reappointment or removal	Substantial increase in the board's time
Fiduciary duties of the directors additionally	• The fiduciary duties of the directors have been laid down by law under the New Act and hence the directors' would have to be aware of these duties and act accordingly in the boards	Marginal increase in the board's time
Appointment of whole time key management personnel	• The whole time key management has been defined by the New Act and their appointment, including the remuneration, will be through a board resolution and would have to be recommended by the Nomination and Remuneration Committee	Marginal increase in the board's time
Independent Directors – definitions, selection, tenure and entitlements	• The boards would have to take note of the changes in the criteria and the tenure of the Independent Directors and take necessary action to reconstitute the boards if necessary and set out policies in this regard • The boards may also have to make the selection of new Independent Directors following the process set out in the New Act and the Rules • The boards may have to examine their existing policies on the entitlements of the Independent Directors • The boards would have to take fresh declaration from the Independent Directors	Considerable increase in the board's time
Performance evaluation of the board, Chairman and the directors	• The boards would have to lay down the procedures and methods for annual formal evaluation of performance of the board, its committees and individual directors, Chairman and of the Independent Directors (before reappointment)	Substantial increase in the board's time
Code for independent directors and additional responsibilities	• The Schedule IV of the New Act specifies additional responsibilities for the Independent Directors and their duties and functions for the first time • The companies would need to have systems which would help familiarise the Independent Directors with these responsibilities • The Independent Directors will have to meet exclusively at least once annually in which they will have to review the performance of the non-Independent Directors, the Chairperson, and assess the timelines of the information flow between the management and the board • To do this the Independent Directors would have to have proper procedures in place which would enable them to conduct such meetings and carry out the reviews	Considerable increase in the board's time
Internal financial controls, risk management, regulatory compliance	• The New Act lays emphasis on the internal financial controls of companies, risk management and regulatory compliance as the Directors' Responsibility Statement now requires disclosures and positive affirmations by the board in regard to the adequacy and effective working of the systems in this regard • The boards will have to institute appropriate processes which will enable them to assess the working and adequacy of the internal financial controls, risk management and regulatory compliance systems before such affirmations can be made in the Directors' Responsibility Statement	Significant increase in the board's time

Penalties for contravention

For listed companies:

- Punishment with imprisonment for a term up to one year or a fine of a minimum of not less than ₹ 50,000 but which may extend to ₹ 5 lakh, or both, for the managing director, the whole-time director in charge of finance, the Chief Financial Officer of all listed companies and in their absence, any other person charged by the board with the duty of complying with the requirements of Section129, in case of contravention of the provisions of Section 129 related to Financial Statement giving true and fair view of the company.
- Punishment with a fine of a minimum of ₹ 50,000 and a maximum of ₹ 25 lakh for the company and punishment of a minimum fine ₹ 50,000 and maximum of ₹ 5 lakh or imprisonment for a term which may extend to three years or both, for every officer of the company who is in default, for contravention of the provisions of Section 134 related to the company's financial statement and the board's report and Directors' Responsibility Statement.
- Punishment with a fine of a minimum of ₹ 1 lakh and a maximum of ₹ 5 lakh for the director of the company contravening the provisions of Section 166 related to the fiduciary duties of the director.
- Punishment with a fine of a minimum of ₹ 1 lakh and a maximum of ₹ 5 lakh for the company and punishment of a minimum fine ₹ 50,000 and ₹ 1000 for every day in default thereafter for every director and key managerial personnel of the company who is in default, for the contravention of Section 203 related to the appointment of whole time key management personnel.

Key questions for the Boards and Managements to consider

The New Act has several new responsibilities and duties for the boards and the directors, some of which require public disclosures of policies, mandatory performance evaluation of boards and directors, as well as positive affirmations of the adequacy and effective working of systems relating to internal financial controls, risk management and regulatory compliance. Contravention of these and other provisions attract both civil and criminal penalties.

When the boards are implementing the new provisions of the New Act, they may consider asking the following questions, which may help them in the planning process and lead them to discharge their duties and responsibilities:

Are the directors aware of their roles, responsibilities and duties under the New Act? How would the company help in this process?
Would the full board participate in setting out the policies for corporate social responsibility, internal financial controls, regulatory compliance and risk oversight and in assessing the key risks and vulnerabilities, and would the board be involved in the monitoring of these policies?
How will the board satisfy itself about the adequacy and effectiveness of the systems of internal financial controls, and regulatory compliance so that it could give affirmations in the Directors’ Responsibility Statement?
How should the board assure itself of the reliability of disclosures to be made on behalf of the board?
How will the performance of the board and its directors be evaluated?
What process should the board follow in evaluating the performance of the board and of the Independent Directors prior to reappointment?
What process should the Independent Directors follow in reviewing the performance of the non-executive directors and the Chairperson, assessing the quality, quantity and timeliness of the information flow, scrutinising the performance of the management?
What process should the Independent Directors follow to satisfy themselves on the integrity of the financial information and that the systems of financial controls and risk management are robust and defensible?
What process should the board follow to review and approve the related-party transactions?
Do the board have charters for the various committees of the board?
Should the board and the Independent Directors document all processes related to board functioning and management oversight?

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