

## NEW COMPANIES ACT, 2013: IT'S IMPACT ON CORPORATE GOVERNANCE

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### ABSTRACT

*Good Corporate Governance is based on the satisfaction of all kinds of stakeholders, CSR and ethics. It is about Commitment to values, Ethical business conduct, and Exercise of powers in a responsible way. It is difficult to achieve excellence without good governance in long term.*

*The Companies Act 2013 envisages radical changes in the area of Corporate Governance and is set to have far-reaching implications. The new regime is expected to significantly change the manner in which corporates operate in India. Severe consequences for non-compliance: While the bar for corporate governance has been raised, the penal consequences have been exponentially increased with a large number of sections reserving provisions for the prosecution of directors, officers in default and key managerial personnel. Stricter regime even for unlisted public companies and private companies: There is a clear shift towards closely monitoring unlisted public companies and large private companies with enhanced compliance requirements encompassing disclosures, transparency and governance procedures.*

### **KEY WORDS**

Corporate Governance, CSR, Disclosures, Transparency

## **OBJECTIVE OF THE STUDY**

The main objective of the study is to understand the new provisions of Companies Act, 2013 regarding better Corporate Governance.

For achieving this main objective following sub-objectives have been framed:

- 1) To understand the meaning and role of Corporate Governance.
- 2) To study the new provisions of Companies Act, 2013.

## **RESEARCH METHODOLOGY**

The Research design is descriptive and exploratory in nature. The research is primarily based on secondary data. (Secondary data is collected from Books, Reports, Magazines and Journals.) The approach of this paper can be described as integrative, conceptual, and theory building rather than purely empirical one.

## **INTRODUCTION:**

Corporate governance refers to the system of structures, rights, duties, and obligations by which corporations are directed and controlled. The governance structure specifies the distribution of rights and responsibilities among different participants in the corporation (such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and specifies the rules and procedures for making decisions in corporate affairs. Governance provides the structure through which corporations set and pursue their objectives, while reflecting the context of the social, regulatory and market environment. Governance is a mechanism for monitoring the actions, policies and decisions of corporations. Governance involves the alignment of interests among the stakeholders.

Corporate governance has also been defined as "a system of law and sound approaches by which corporations are directed and controlled focusing on the internal and external corporate structures

with the intention of monitoring the actions of management and directors and thereby mitigating agency risks which may stem from the misdeeds of corporate officers."

Corporate governance is the convergence of economics and relationships that determine a company's direction and performance. Its purpose is to optimize resources to promote accountability and efficiency within the corporate structure. Most companies' corporate governance is set by their boards of directors, which establish and promote policies for the management and employees of the corporation. The board of directors is responsible to shareholders and customers for the corporation's outcomes.

Corporate governance is the way a corporation polices itself. In short, it is a method of governing the company like a sovereign state, instating its own customs, policies and laws to its employees from the highest to the lowest levels. Corporate governance is intended to increase the accountability of your company and to avoid massive disasters before they occur. Failed energy giant Enron, and its bankrupt employees and shareholders, is a prime argument for the importance of solid corporate governance. Well-executed corporate governance should be similar to a police department's internal affairs unit, weeding out and eliminating problems with extreme prejudice. A company can also hold meetings with internal members, such as shareholders and debtholders – as well as suppliers, customers and community leaders, to address the request and needs of the affected parties.

#### Corporate Governance as Risk Mitigation

Corporate governance is of paramount importance to a company and is almost as important as its primary business plan. When executed effectively, it can prevent corporate scandals, fraud and the civil and criminal liability of the company. It also enhances a company's image in the public eye as a self-policing company that is responsible and worthy of shareholder and debtholder capital. It dictates the shared philosophy, practices and culture of an organization and its employees. A corporation without a system of corporate governance is often regarded as a body without a soul or conscience. Corporate governance keeps a company honest and out of trouble. If this shared philosophy breaks down, then corners will be cut, products will be defective and

management will grow complacent and corrupt. The end result is a fall that will occur when gravity – in the form of audited financial reports, criminal investigations and federal probes – finally catches up, bankrupting the company overnight. Dishonest and unethical dealings can cause shareholders to flee out of fear, distrust and disgust.

### **INITIATIVES FOR BETTER CORPORATE GOVERNANCE:**

#### **1. BOARD STRUCTURE AND RESPONSIBILITY**

- Enhanced responsibility for the board and its committees
- Specified unlisted companies to have independent directors (ID); mandatory code for IDs
- Mandatory woman director for certain companies.
- Mandatory key managerial personnel (KMP) – CEO/MD

#### **2. DISCLOSURES AND REPORTING**

The prescribed disclosures under the Annual Return show significant transformation in non-financial annual disclosures and reporting by companies as compared to the existing format. Similar to the existing compliance certificate as stipulated under section 383A of Companies Act, 1956, certification of compliances has been prescribed under clause 92(1)(ix).

#### **National Financial Reporting Authority**

An umbrella body constituted on the lines of PCAOB of USA. It is a quasi-judicial body. It shall consist of a Chairman and members not exceeding 15. Purpose is to ensure the compliance in auditing, and action if there is any gap.

Functions and Role of NFRA

Make recommendations to the Central Government on the formulation and lying down of accounting and auditing policies and standards. Monitor and enforce the compliance with accounting standards and auditing standards. Oversee the quality of service of the professions

Powers of NFRA

Have the power to investigate, either suo motu or on a reference made to it by the Central Government, Have the same powers as are vested in a civil court,

Have the power to make order for—

(A) Imposing penalty of -

(I) one lakh rupees to five times of the fees received, in case of individuals; and

(II) ten lakh rupees, to ten times of the fees received, in case of firms;

(B) Debarring the member or the firm from practice as member of the Institute for a minimum period of six months to ten years Authority.

Appeal before the Appellate Authority: Any person aggrieved may prefer an appeal before the Appellate Authority constituted by the Central Government.

### **3. SECRETARIAL COMPLIANCES**

#### **Introduction of Secretarial Standards**

For the first time, the Secretarial Standards has been introduced and provided statutory recognition. It is the beginning of a new era where non-financial standards have been given importance and statutory recognition besides financial standards.

According to the clause, “Every company shall observe Secretarial Standards with respect to General and Board Meetings specified by the Institute of Company Secretaries of India. [Clause 118(10)]

A duty is casted upon the Company Secretary to ensure that the company complies with the applicable Secretarial Standards. [Clause 205]

### **Introduction of Secretarial Audit**

Every listed company and a company belonging to other class of companies as may be prescribed shall; annex with its Board’s report a Secretarial Audit Report, given by a Company Secretary in Practice, in prescribed form.

It shall be the duty of the company to give all assistance and facilities to the Company Secretary in Practice, for auditing the secretarial related records of the company.

The Board of Directors, in their report shall explain in full any qualification or observation or other remarks made by the Company Secretary in Practice in his report.

If a company or any officer of the company or the Company Secretary in Practice contravenes the provisions of this section, the company, every officer of the company or the Company Secretary in Practice, who is in default, shall be punishable with fine of Rs one lakh rupees to five lakh rupees.

### **4. RELATED PARTY TRANSACTIONS**

Related party is also defined in the Act

Transactions with related party include: Sale, purchase or supply of any goods or materials, Availing or rendering of any services, Selling or otherwise disposing of, buying or leasing property of any kind, Appointment of any agents for purchase of sale of goods, materials, services or property, Appointment to any office or place of profit in the company, Underwriting agreement.

Every contract or arrangement entered into with a related party shall be referred to in the Board's Report along with the justification. No approval of the central government is required for entering into any related party transactions. Under the Companies Act, 1956 approval is required under section 297. Apart from the existing transactions, certain new related party transactions are also provided for which approval of Board will be required.

Where a one person company limited by shares or by guarantee enters into a contract with the sole member of the company who is also its director, the company shall, unless the contract is in writing, ensure that the terms of the contract or offer are contained in the memorandum or are recorded in the minutes of the first Board meeting held after entering into the contract. The company shall inform the Registrar about every contract entered into by the company and recorded in the minutes (Clause 193)

### **5. Class Action Suits**

For the first time, a provision has been made for class action suits. The Act provides for class action suit by specified number of members or depositors against the company. If the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors. The order passed by the Tribunal shall be binding. The requisite number of petitioners in the case of a company having a share capital, is not less than 100 members of the company or not less than such percentage as may be prescribed, whichever is less, or any member or members holding not less than prescribed percentage of the issued share capital. In the case of a company not having a share capital, not less than one-fifth of the total number of its members. The requisite number of depositors is not less than 100. The Tribunal shall take into account, in particular—whether the member or depositor is acting in good faith in making the application for seeking an order.

### **6. FRAUD**

PSC recommends to define 'fraud' in the Bill.

The term "Fraud" has for the first time been defined in Clause 447 of the Bill. Under the Companies Act, 1956 there is no such provision. Any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. Where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

## **SFIO**

Establishment of the Serious Fraud Investigation Office: The Central Government shall establish--Until the Serious Fraud Investigation Office is established), the SFIO set-up by the MCA shall be deemed to be the SFIO for the purpose of this Act.

The SFIO Shall be headed by a Director who shall be an officer not below the rank of a Joint Secretary having knowledge and experience in dealing with matters relating to corporate.

The SFIO shall consist of such number of experts from the following fields to be appointed by the Central Government from amongst persons of ability, integrity and experience in,—(i) Banking; (ii) Corporate affairs; (iii) Taxation; (iv) Forensic audit; (v) Capital market; (vi) Information technology; (vii) Law; or (viii) Such other fields as may be prescribed.

Statutory status has been given to SFIO: Investigation report of SFIO filed with the Court for framing of charges shall be treated as a report filed by a Police Officer. SFIO shall have power to arrest in respect of certain offences of the Bill which attract the punishment for fraud. Those offences shall be cognizable and the person accused of any such offence shall be released on bail subject to certain conditions provided in the relevant clause of the Bill.

Stringent penalty provided for fraud related offences

## **7. Prohibition on Insider Trading**

New clause has been introduced with respect to prohibition of insider trading of securities.



Director or KMP shall not deal in securities of a company on the basis of non-price sensitive information either on his own behalf or on behalf of any other person.

“Insider trading” has been defined to mean—

(i) an act of subscribing, buying, selling, dealing or agreeing to subscribe, buy, sell or deal in any securities by any director or key managerial personnel or any other officer of a company either as principal or agent if such director or key managerial personnel or any other officer of the company is reasonably expected to have access to any non-public price sensitive information in respect of securities of company; or

(ii) an act of counseling about procuring or communicating directly or indirectly any non-public price-sensitive information to any person;

Similarly, the definition of price sensitive information has also been included. “Price-sensitive information” has been defined to mean any information which relates, directly or indirectly, to a company and which if published is likely to materially affect the price of securities of the company.

Contravention: Punishable with imprisonment for a term which may extend to 5 years or with fine of Rs 5 lakh rupees to 25 crore rupees or three times the amount of profits made out of insider trading, whichever is higher, or with both.

## **8. CORPORATE SOCIAL RESPONSIBILITY**

India perhaps the first country to provide CSR in its Statute. Countries like Indonesia, and France have CSR Legislations in a very loose format.

Section 135 on CSR has been notified effective from April 01, 2014

Applicability: To all companies that have either of the following

► Net worth of INR 500 crore or more (about \$90 m);

► Turnover of INR 1000 crore or more (about \$180 m)

► Net profit of INR 5 crore or more

during any financial year shall constitute a CSR Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director. The CSR Committee shall formulate and recommend CSR Policy.

CSR Committee:

Comprising of 3 or more directors with at least one independent director,

Composition to be disclosed in the Annual Report of Board

CSR committee of an unlisted company or private company to have without independent director

CSR committee of a private company having only 2 directors shall have only 2 members

CSR committee of a Foreign Company shall have at least 2 members

CSR Spending: The Board of every company shall ensure that the company spends in every financial year at least 2% of the average net profits of the company made during the 3 immediately preceding financial years in pursuance of its CSR policy.

Which Company to Comply: Company including its holding or subsidiary and a foreign company shall comply with the provisions of Sec 135

Exempted Companies: Company which ceases to be covered for 3 consecutive financial years.

CSR Activities

Schedule VII has been revised and CSR activities have been amended. The government has identified 10 major areas to claim credit for the 2% spending.

## **Non-Compliance**

Self-Reporting and Self Disclosure: Approach is to 'comply or explain': In case the company has failed to spend the 2% of the Average Net Profit (INR) of the last 3 financial years, the company is to provide the reasons for not spending the amount. The Act does not prescribe any penal provision if a company fails to spend amount on CSR activities. The Board will need to explain the reasons for non-compliance with its report.

## **String Punishment for Failure to Distribute Dividends**

Stringent punishment is proposed for failure to distribute dividend within thirty days of its declaration. According to Clause 127, every director of the company shall, if he is knowingly a party to the default, be punishable with imprisonment which may extend to two years and with fine which shall not be less than 1000 rupees for every day during which such default continues and the company shall be liable to pay simple interest at the rate of 18% per annum during the period for which such default continues.

## **THE NEGATIVE SIDE**

### 1. Prohibit Political Funding

## **Political Funding: A Root Cause of Corruption**

The entire system of political funding in India makes cooked books not only possible, but a necessity. When we see our political leaders whizzing around in hired helicopters and chartered planes, let us be clear that some substantial contribution has been made by some industrial house or the other. There is thus a need to review the provisions of Section 293A of the Companies Act that permits companies to contribute officially up-to 5% of their net profits towards political funds. Bad News is that the Company Act 2013 proposed to enhance contribution from 5% to 7.5%.

2. Section 203 of Companies Act, 2013, provides that all the private companies are exempted from the appointment of “KMP” which hampered the current position of the Company Secretary because the secretary covered by the term “KMP”, adding more bitter to this, that only those public companies are required to appoint Company Secretary which are having a paid up Capital of Rs. 10 Crore or more.

The important thing is that private companies, which comprise about 93 percent approx., are left out by the provisions and the Public Companies are about approx. 7 percent only are in the ambit of the new act and are required to appoint CS; the question is whether this step ruining the efforts regarding ensuring Corporate Governance or CS.

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