

Corporate Governance

3.1 Introduction

3.1.1 Provisions as contained in the Companies Act, 2013

The Companies Act, 2013 was enacted on 29 August 2013 replacing the Companies Act, 1956. In addition, the Ministry of Corporate Affairs had also notified (31 March 2014) Companies Rules, 2014 on Management and Administration, Appointment and Qualification of Directors, Meetings of Board and its powers, and Accounts. The Companies Act, 2013 together with the Companies Rules, 2014 provide a robust framework for corporate governance. The requirements, *inter alia* provided for:

Qualifications for Independent Directors along with the duties and guidelines for professional conduct (Sections 149 (6) & (8) and Schedule IV read with Rule 5 of the Companies (Appointment and Qualification of Directors), Rules, 2014).

Mandatory appointment of a woman director on the board of listed companies [Section 149(1)] and such other class of companies as per Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

Mandatory establishment of certain committees like Corporate Social Responsibility Committee [Section 135], Audit Committee [Section 177(1)], Nomination and Remuneration Committee [Section 178(1)] and Stakeholders Relationship Committee [Section 178(5)].

Holding of a minimum of four meetings of Board of Directors every year in such a manner that not more than 120 days shall intervene between two consecutive meetings of the Board [Section 173(1)].

3.1.2 SEBI guidelines on Corporate Governance

Subsequent to the enactment of Companies Act, 2013, Securities and Exchange Board of India (SEBI) amended (April and September 2014) clause 49 of the Listing Agreement to align it with the corporate governance provisions specified in the Companies Act, 2013. SEBI notified (2 September 2015) the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, which came into effect from 1 December 2015 repealing the earlier provisions.

3.1.3 Corporate Governance for Public Sector Undertakings

As per Section 292A of the erstwhile Companies Act, 1956, every Public Company whose paid up capital was not less than five crore of rupees should constitute an Audit Committee which shall consist of not less than three directors other than Managing or whole time directors. Government of Kerala had issued instructions (November 2008) regarding the constitution of Audit Committee as a part of strengthening the corporate governance in State Public Sector Undertakings. Thus, the intention of the State Government was that all PSUs irrespective of their paid up capital should constitute an Audit Committee. However, Companies Act, 2013 which replaced Companies Act, 1956, vide section 177 stipulated that all listed companies and such other class or classes of companies as may be prescribed shall constitute an Audit Committee with a minimum of three directors as members with independent directors forming a majority. Further, Rule 6 of the Companies (Meetings of Board and its powers) Rules, 2014, prescribed the following class of companies shall also constitute an Audit Committee: (i) Public Companies having paid up share capital of rupees ten crore or more, or (ii) Public Companies having turnover of rupees one hundred crore or more, or (iii) Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding rupees fifty crore.

Compliance to the above provisions of the Companies Act, 2013, Companies (Appointment and Qualification of Directors) Rules, 2014, Companies (Meetings of Board and its powers) Rules, 2014 by the PSUs was reviewed. As there is no listed Government company in Kerala, the compliance to SEBI guidelines was not reviewed.

3.1.4 Review of compliance of the Corporate Governance provisions by PSUs

As on 31 March 2022, there were 131 working PSUs (including four Statutory corporations) in Kerala under the audit jurisdiction of the CAG of India. In the context of the policy of the Government to grant more autonomy to the PSUs, corporate governance has assumed importance. Out of 131 working PSUs²⁵, 73²⁶ PSUs (*Appendix XVI*) which had furnished (till 30 October 2022) the details were considered for analysis. Details called for in respect of the remaining PSUs are awaited.

²⁵ Excludes 19 non-working PSUs.

²⁶ Including one Statutory corporation, Kerala State Warehousing Corporation.

3.2 Board of Directors – Meetings and its composition

3.2.1 Meetings of Board of Directors

As per Section 173(1), companies should hold a minimum of four meetings of Board of Directors every year in such a manner that not more than 120 days shall intervene between two consecutive meetings of the Board. Audit observed that 40 working Government companies/Government controlled other companies²⁷ mentioned in *Appendix XVII* did not conduct the required number of four meetings during the year 2021-22.

3.2.2 Independent Directors

The Board is the most significant instrument of corporate governance. The presence of independent representatives on the Board, capable of taking an independent view on the decisions of the management is widely considered as a means of protecting the interests of shareholders and other stakeholders. In terms of Section 149 (4) of the Companies Act, 2013, where the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise independent directors and, in case he is an executive director, at least half of the Board should comprise independent directors. As per Clause 49 (II) (B) (1) of Listing Agreement of SEBI, ‘independent director’ shall mean a non-executive director, other than a nominee director of the company. Further, as per Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014, the following class or classes of companies shall have at least two directors as independent directors:

- (i) Public Companies having paid up share capital of rupees ten crore or more, or
- (ii) Public Companies having turnover of rupees one hundred crore or more, or
- (iii) Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding rupees fifty crore.

The representation of independent directors in the Board of companies was examined with reference to Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

Audit observed that of the 72 companies which had furnished information, 27 companies were public companies and 15 out of them satisfied the above criteria. Four out of the 15 companies mentioned at Sl. No. 1 to 4 in **Table 3.1** below had appointed independent directors in compliance to the Rules. The list of remaining 11 Companies, which satisfied the criteria but did not appoint independent directors in the Board, is shown in *Appendix XVIII*. Companies mentioned in Sl. No. 5 and 6 of **Table 3.1** also appointed independent directors in this regard, even though they did not fall under the given class of companies, and hence was worth emulating.

²⁷ 101 working Government companies furnished the details of Board Meetings.

The list of six out of the 72 Government companies/Government controlled other companies which appointed independent directors is listed in **Table 3.1**.

Table 3.1: PSUs which have appointed independent directors

| Sl No. | Name of company | Total number of directors in the Board | Number of independent directors in Board |
|--------|---|--|--|
| 1 | Roads and Bridges Development Corporation of Kerala Limited | 5 | 2 |
| 2 | Malabar Cements Limited | 9 | 2 |
| 3 | The Travancore Cochin Chemicals Limited | 9 | 3 |
| 4 | Traco Cable Company Limited | 8 | 2 |
| 5 | Kerala State Drugs and Pharmaceuticals Limited | 4 | 3 |
| 6 | Kerala State Poultry Development Corporation Limited | 8 | 8 |

(Source: Details received from the PSUs)

3.2.3 Woman Director in the Board

Section 149 (1) of the Companies Act, 2013, stipulates that the Board of Directors of such class or classes of companies as may be prescribed, shall have at least one woman director in its Board. Further, as per Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014 the following class of companies shall appoint at least one woman director:

- (i) Every listed company
- (ii) Every other public company having
 - (a) Paid up share capital of rupees one hundred crore or more, or
 - (b) Turnover of rupees three hundred crore or more.

Audit observed that six out of the 72 companies were public companies satisfying the criteria of either paid up share capital or turnover. These companies however did not have women directors in their board as stipulated. Audit also observed that 26 out of 72 Government companies/ Government controlled other companies, which did not fall under the given class of companies, had appointed women directors in their Board which was worth emulating by other companies.

3.3 Appointment and functioning of Independent Directors

3.3.1 Declaration of status

Section 149 (7) of the Companies Act, 2013, stipulates that the independent director shall make a declaration that he meets the status of independent director.

As per the information furnished by the companies, the directors in four out of six companies viz., Malabar Cements Limited, The Travancore Cochin Chemicals Limited, Traco Cable Company Limited and Kerala State Poultry Development

Corporation Limited had declared their independent status.

3.3.2 Training of Independent Directors

Schedule IV of Companies Act, 2013 - Para (III) (1) – Duties of Independent Directors and Clause 49 (II) (B) (7) (a) & (b) and Regulations 25 (7) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 stipulate that the company shall provide suitable training to independent directors to familiarize them with the company, their roles, rights, responsibilities in the company, nature of the industry in which the company operates, business model of the company, *etc.* However, it was observed that none of the six PSUs which had independent directors in their Board had provided training to those independent directors during 2021-22.

3.3.3 Attending General Meetings of the Company

Schedule IV (III) (5) of the Companies Act, 2013 states that independent directors shall strive to attend the general meetings of the Company. At least one independent director appointed on the boards of the five companies attended the general meetings held in 2021-22. The independent director of Malabar Cements Limited did not attend the general meeting.

The status of attendance of independent directors in the general meetings held in 2021-22 is given in **Table 3.2**

Table 3.2: Attendance of independent directors in General Meeting

| Sl No. | Name of company | Number of independent directors on Board | Number of independent directors attended general meeting |
|--------|---|--|--|
| 1 | Roads and Bridges Development Corporation of Kerala Limited | 2 | 1 |
| 2 | Kerala State Drugs and Pharmaceuticals Limited | 3 | 1 |
| 3 | Malabar Cements Limited | 2 | 0 |
| 4 | The Travancore Cochin Chemicals Limited | 3 | 3 |
| 5 | Traco Cable Company Limited | 2 | 1 |
| 6 | Kerala State Poultry Development Corporation Limited | 8 | 3 |

3.3.4 Meeting of Independent Directors

Schedule IV (VII) (1) of the Companies Act, 2013 require that independent directors shall meet at least once in a financial year, without the attendance of non-independent directors and members of management. Further, Schedule IV (VII) (2) of the Companies Act, 2013 provides that all the independent directors strive to attend such separate meeting of independent directors. It was seen that separate meeting of independent directors was not conducted in any of the PSUs.

3.4 Filling up the posts of Key Managerial Personnel

3.4.1 It was observed that in 11 companies²⁸ vacancies of whole time Key Managerial Personnel²⁹ were not filled within the period of six months prescribed in Section 203 (4) of the Companies Act, 2013.

3.5 Audit Committee

3.5.1 Composition of Audit Committee

Section 177 (1) and (2) of the Companies Act, 2013, stipulates that there shall be an Audit Committee with a minimum of three directors as members with independent directors forming a majority. Government of Kerala had also issued instructions (November 2008) regarding constitution of Audit Committee as a part of strengthening corporate governance in State Public Sector Undertakings. However, no Audit Committee was constituted in 52 out of 73 PSUs as shown in *Appendix XIX*. In 17 PSUs, the chairmen of Audit Committee were non-executive directors and in the remaining four PSUs, the chairmen were executive directors.

It was observed that in four out of the 21 PSUs, *viz.*, Kerala Agro Machinery Corporation Limited, Autokast Limited, The Kerala State Women's Development Corporation Limited, and Kerala State Power and Infrastructure Finance Corporation Limited, the Audit Committee though constituted, did not meet even once during 2021-22.

In 15 Government companies and Government controlled other companies, majority of the members of the Audit Committee were not independent directors as per the requirement of Section 177 of the Companies Act, 2013 as detailed in *Appendix- XX*.

3.5.2 Evaluation of Internal Control Systems

Section 177 (4) (vii) of the Companies Act, 2013, stipulate that the Audit Committee should evaluate internal financial control systems and risk management systems. It was seen that the Audit Committee evaluated the internal financial control systems in 15 PSUs but the same were not evaluated by the six PSUs given in **Table 3.3**.

²⁸ The Kerala State Coir Corporation Limited, The Plantation Corporation of Kerala Limited, Kerala State Drugs and Pharmaceuticals Limited, Kerala State Textile Corporation Limited, Malabar Cements Limited, Steel Industrials Kerala Limited, Travancore Titanium Products Limited, Vizhinjam International Seaport Limited, Kerala State Development Corporation for Christian Converts from Scheduled Castes and the Recommended Communities Limited, The Kerala State Women's Development Corporation Limited and United Electrical Industries Limited.

²⁹ As per Section 2(51) of the Companies Act, 2013, Key Managerial Personnel, in relation to a company, means (i) the Chief Executive Officer or the Managing Director or the manager; (ii) the company secretary; (iii) the whole-time director; (iv) the Chief Financial Officer; and (v) such other officer as may be prescribed

Table 3.3: PSUs in which the Audit Committee did not evaluate the internal financial control systems

| Sl. No. | Name of the PSU |
|---------|--|
| 1 | The Kerala State Civil Supplies Corporation Limited |
| 2 | Autokast Limited |
| 3 | Kerala State Textile Corporation Limited |
| 4 | The Kerala State Women's Development Corporation Limited |
| 5 | Kerala State Warehousing Corporation |
| 6 | Kerala State Construction Corporation Limited |

(Source: Details received from the PSUs)

3.5.3 Monitoring of the timeliness in submission of accounts and Auditor's Performance

Instructions of GoK (November 2008) regarding formation of Audit Committee stipulate that Audit Committee should oversee the company's financial reporting process and the disclosure of its financial information to ensure that the financial statements are correct, sufficient, and credible. Majority of the PSUs stated that they had reviewed the financial statements and Auditors' report in the Audit Committee. There was, however, huge pendency in submission of accounts as could be seen from the fact that only five out of 131 PSUs had submitted their accounts for the year 2021-22 as discussed in **Para 2.3.2.1**. Therefore, the absence of Audit Committee in a majority of the PSUs (52 out of the 73 PSUs which had furnished information) shows that the companies' system of internal controls is weak and that there is no oversight of the financial reporting and auditing process, thereby exposing the companies to financial fraud and non-compliance with laws and regulations.

Section 177 (4) (ii) of Companies Act, 2013, stipulates that the Audit Committee shall review and monitor the auditor's independence and performance, and effectiveness of audit process. In 15 out of 21 PSUs (*Appendix-XXI*), the auditor's performance was not reviewed by the Audit Committee.

3.5.4. Review of Information/Documents by Audit Committee

3.5.4.1 All the PSUs are subject to the audit of CAG of India as per the statutory mandate. Section 143 (6) of the Companies Act, 2013, authorises CAG to carry out supplementary audit of accounts of Government companies. Further, Section 177 (4) (iii) of the Companies Act, 2013 provides that Audit Committee shall examine the financial statements and Auditors' Report thereon. Thus, in case of PSUs, it is the responsibility of the Audit Committee to review the findings of CAG including management letters issued by CAG. However, Audit Committee in five PSUs *viz.*, Roads and Bridges Development Corporation of Kerala Limited, Autokast Limited, The Kerala State Women's Development Corporation Limited, Kerala State Warehousing Corporation and Kerala State Construction Corporation Limited, did not review CAG's findings and management letters of CAG.

Section 177 (4) of Companies Act, 2013 stipulates that the Audit Committee shall act in accordance with the terms of reference specified in writing by the Board

which includes review and monitoring of the auditors' independence and performance, and effectiveness of audit process; examination of the financial statements and the auditors' report thereon; evaluation of internal financial controls and risk management systems *etc.* Further, as per Government of Kerala's instructions to PSUs (November 2008), the Audit Committee should review (i) discussions with the auditors periodically about internal control system and the scope of audit including observations of the auditors, (ii) the Audit Para, Audit Report and comments of the Accountant General (iii) with management, the annual financial statements before submission to the Board (iv) with the management, external and internal auditors, the adequacy of internal control system (v) discussion with external auditors before the audit commences, nature and scope of audit as well as post-audit discussion to ascertain any area of concern.

The details pertaining to the compliance of the aforesaid provisions by the 21 PSUs with Audit Committees are indicated in **Appendix XXII**. Out of 21 PSUs, the Audit Committee of 15 PSUs evaluated the internal financial control systems, 14 PSUs reviewed and monitored the Statutory/internal auditors' performance and effectiveness of audit process, 18 PSUs reviewed financial statements and auditors' reports, 16 PSUs reviewed the findings of CAG and examined the management letters issued by CAG, and 7 PSUs discussed the nature and scope of audit with the Statutory auditors before commencement and after completion of audit to focus on the areas of concern.

Section 138 (1) of the Companies Act, 2013, mandates appointment of internal auditors for prescribed class of companies. The internal audit activity helps an organization to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Since the Audit Committee plays a vital role in evaluation of internal controls, all the reports of internal audit (including the role and size of internal audit being commensurate with the nature and size of operations of the company) should be reviewed by the Audit Committee and the recommendations thereof are to be implemented by the companies. Failure of the Audit Committee in evaluating the reports may expose the companies to financial and governance risks.

3.5.4.2 Discussion with Statutory auditors

Section 177 (5) of the Companies Act, 2013 states that Audit Committee may discuss any related issues with the internal and Statutory auditors and the management of the company. Further, Government of Kerala issued (November 2008) instructions to PSUs that Audit Committee should hold discussions with the Statutory auditors before the audit commences on the nature and scope of audit to ascertain the areas of concern. Audit Committee did not discuss the nature and scope of audit with the Statutory auditors before commencement and after completion of audit to focus on the areas of concern in 14 PSUs as indicated in **Appendix XXIII**.

3.6 Other Committees

3.6.1 Whistle Blower Mechanism

Section 177 (9) of the Companies Act, 2013 and Rule 7 of the Companies (Meeting of Board and its Powers) Rules, 2014 stipulate that listed companies and such other class of companies *i.e.*, companies which receive deposits from public and which have borrowed from Banks and Public Financial Institutions in excess of rupees 50 crore shall constitute a vigil mechanism and that the Audit Committee shall review the functioning of the Whistle Blower Mechanism.

Up to 2020-21, nine companies had formed whistle blower mechanism. Three more companies intimated in 2021-22 that they have also formed the mechanism taking the total number of such companies to twelve. It was observed that four companies which satisfied the criteria for forming whistle blower mechanism either in 2021-22 or earlier did not form such a mechanism.

3.7 Conclusion

This chapter dealt with the adherence to corporate governance guidelines by the Government companies. Matters related to appointment of independent directors/women directors in the board of directors of Government companies, the constitution of Audit Committee, etc. are highlighted in this chapter. During 2021-22, out of the 127 working companies, 40 companies did not conduct the mandatory requirement of four meetings of the Board of Directors. Out of 15 companies that met the criteria only four had appointed independent directors. Out of 21 PSUs, the Audit Committee of 15 PSUs evaluated the internal financial control systems, 14 PSUs reviewed and monitored the Statutory auditors'/ internal auditors' performance and effectiveness of audit process, 18 PSUs reviewed financial statements and auditors' reports, 16 PSUs reviewed the findings of CAG and examined the management letters issued by CAG, and seven PSUs discussed the nature and scope of audit with the Statutory auditors before commencement and after completion of audit to focus on the areas of concern.

3.8 Recommendation

1. *Government should ensure that regular meetings of Board of Directors are held as per the provisions of the Companies Act, 2013.*
2. *Government should ensure that training is provided to the directors of the companies to keep themselves updated with the changes taking place in the business environment.*
3. *Government must ensure that Audit Committees review the internal audit processes including the internal audit reports and action taken on them by the companies as per the provisions of the Companies Act, 2013.*
4. *Government must ensure that Audit Committees discuss with the Statutory Auditors the areas of concerns in the companies and suggest*

additional areas which require further probe and reporting.

- 5. Government must ensure that whistle blower mechanism is formed by the companies which are legally required to do so.*