

Chapter III

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 *etc.* The Companies Act, 2013 and Companies Rules, 2014 provide a robust framework for corporate governance. The requirements, *inter alia* provided for:

Qualifications of Independent Directors along with the duties and guidelines for professional conduct (Sections 149(6) & 149(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(1)], 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 Corporate Governance for Public Sector Enterprises

As per Section 292A of the erstwhile Companies Act, 1956, every Public Company whose paid up capital was not less than ₹ five crore 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 corporate governance in State Public Sector Enterprises. Thus, the intention of the State Government was that all PSEs irrespective of their paid up capital should constitute an Audit Committee. However, the Companies Act, 2013 which replaced Companies Act, 1956, vide section 177(1) (as amended vide notification at 03.01.2018) stipulated that every public listed company and such other classes of companies, as may be prescribed, shall constitute an Audit Committee. Section 177(2) of the Companies Act prescribed that such an Audit Committee shall consist of a minimum of three directors, with independent directors forming a majority. Further, Rule 6 of the Companies (Meetings of Board and its powers) Rules 2014, states that a company covered under Rule 4 of the Companies (Appointment and Qualification of Directors) Rules 2014, shall constitute an Audit Committee which *inter alia* include (i) Public Companies having paid up share capital of ₹10 crore or more, or (ii) Public Companies having turnover of ₹100 crore or more, or (iii) Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding ₹50 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 PSEs was reviewed. As there is no listed Government company in Kerala, the compliance to applicable Securities and Exchange Board of India (SEBI) guidelines was not reviewed.

3.1.3 Review of compliance of the Corporate Governance provisions by PSEs

As on 31 March 2023, there were 131 working PSEs (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 PSEs, corporate governance has assumed importance. Out of 131 working PSEs²⁷, 101²⁸ PSEs (*Appendix 17*) which had furnished (till 31 December 2023) the details were considered for analysis. Details called for in respect of the remaining PSEs are awaited.

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 out of 97 companies²⁹, 20 companies mentioned in *Appendix 18* did not conduct the required number of four meetings during the year 2022-23.

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

²⁷ Excludes 18 non-working PSEs.

²⁸ Including four Statutory Corporations namely Kerala State Warehousing Corporation, Kerala Financial Corporation, Kerala State Road Transport Corporation and Kerala Industrial Infrastructure Development Corporation.

²⁹ 97 working Government companies furnished the details of Board Meetings.

independent view on the decisions of the management is widely considered as a means of protecting the interests of shareholders and other stakeholders. 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 out of the 97 companies which had furnished information, 38 companies were public companies and 17 out of them satisfied the above criteria. However, eleven Companies, which satisfied the criteria, did not appoint independent directors in the Board as shown in *Appendix 19*.

Remaining six companies³⁰ which fulfilled the criteria adhered to the requirements of the codal provisions.

Three companies³¹ though not required to fulfill the requirements appointed the independent directors in their board and hence were worth emulating.

3.3 Functioning of Independent Directors

3.3.1. 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.

Out of 17 Government companies referred to in *Paragraph 3.2.2*, six had appointed the independent directors in their boards. However, none of the independent directors of two of these companies viz., Malabar Cements Limited and Kerala State Power and Infrastructure Finance Corporation Limited attended the general meetings.

3.3.2 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 shall strive to attend the said meeting. Out of six companies referred

³⁰ Cochin Smart Mission Limited, Kerala State Electricity Board Limited, Kerala State Power and Infrastructure Finance Corporation Limited, Malabar Cements Limited, Roads and Bridges Development Corporation of Kerala Limited and The Travancore Cochin Chemicals Limited.

³¹ Kerala Aqua Ventures International Limited, Kerala State Handicapped Persons' Welfare Corporation Limited and Vazhakulam Agro and Fruit Processing Company Limited.

to in **Paragraph 3.3.1**, independent directors of Kerala State Electricity Board Limited, Roads and Bridges Development Corporation of Kerala Limited and Kerala State Power and Infrastructure Finance Corporation Limited did not even meet once separately in a financial year.

3.3.3 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 ₹100 crore or more, or
 - (b) Turnover of ₹300 crore or more.

Audit observed that five³² out of the 38 public companies satisfied the criteria of either paid up share capital or turnover. Out of the above five companies, one company³³ did not have woman director in its Board, as stipulated.

3.4 Audit Committee

3.4.1 Composition of Audit Committee

Government of Kerala had issued instructions (November 2008) regarding constitution of Audit Committee as a part of strengthening corporate governance in State Public Sector Enterprises. The GoK instructions stipulate that the Audit Committee shall consist of not less than three directors and such number of other directors as the Board may determine, other than the managing or whole-time directors. Chairman of Audit Committee will be a non-executive director. However, Audit Committee was constituted only in 35 (including two Statutory corporations) out of 101 PSEs. The list of 66 PSEs which have not constituted Audit Committee is shown in **Appendix 20**. Out of 35 PSEs which constituted Audit Committee, six PSEs had executive directors as chairmen, instead of non-executive directors as stipulated.

The GoK circular also stipulated that the Audit Committee shall meet at least three times in a year. It was observed that in six³⁴ out of the 35 PSEs, the constituted Audit Committee did not meet even once during 2022-23. Likewise, 16 PSEs³⁵ conducted less than three meetings.

³² Cochin Smart Mission Limited, Kerala Feeds Limited, Kerala State Electricity Board Limited Roads and Bridges Development Corporation of Kerala Limited and The Travancore Cochin Chemicals Limited.

³³ Kerala State Electricity Board Limited.

³⁴ The Plantation Corporation of Kerala Limited, Kerala Automobiles Limited, Trivandrum Spinning Mills, The Kerala State Coir Corporation, Kerala Electrical and Allied Engineering Company Limited and Kerala State Handicapped Persons' Welfare Corporation Limited.

³⁵ Kerala Agro Machinery Corporation Limited, Kerala State Beverages (M&M) Corporation Limited, Kerala State Construction Corporation Limited, Kerala State Mineral Development Corporation Limited, Kerala State Warehousing Corporation, Roads and

Section 177(1) and 177(2) of the Companies Act, 2013, stipulate that there shall be an Audit Committee with a minimum of three directors as members with independent directors forming a majority. Out of 35 PSEs which constituted Audit Committee, 33 were companies. Out of 33, 27 companies (*Appendix 21*) did not have any independent director in their Audit Committee and two companies³⁶ did not have independent directors in majority in their Audit Committee.

3.4.2 Review of Information/Documents by Audit Committee

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 GoK instructions to PSEs (November 2008), the Audit Committee should (i) discuss with the auditors periodically about internal control system and the scope of audit including observations of the auditors, (ii) review the Audit Para, Audit Report and comments of the Accountant General (iii) review with management, the annual financial statements before submission to the Board (iv) review with the management, external and internal auditors, the adequacy of internal control system (v) discuss with external auditors before the audit commences, nature and scope of audit as well as post-audit discussion to ascertain any area of concern.

Further, all the PSEs 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. Thus, in view of the above, it is the responsibility of the Audit Committee to review the findings of AG including management letters issued by AG.

Instructions of GoK (November 2008) regarding formation of Audit Committee also stipulate that Audit Committee should oversee the PSEs' financial reporting process and the disclosure of their financial information to ensure that the financial statements are correct, sufficient, and credible. There was, however, huge pendency in submission of accounts as could be seen from the fact that only 12 out of 131 PSEs had submitted their accounts for the year 2022-23 as discussed in *Paragraph 2.3.2.1*. The absence of Audit Committee in a majority of the PSEs (66 out of the 101 PSEs 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.

The details pertaining to the compliance with the aforesaid provisions by the 35

Bridges Development Corporation of Kerala Limited, Steel Industrials Kerala Limited, The Travancore Cements Limited, Travancore Titanium Products Limited, Kerala Small Industries Development Corporation Limited, Kerala Social Security Pension Limited, Kerala State Handloom Development Corporation Limited, Malabar Cements Limited, The State Farming Corporation of Kerala Limited, The Travancore Cochin Chemicals Limited, and Transformers and Electricals Kerala Limited.

³⁶ Kerala State Electricity Board Limited and Kerala State Handicapped Person's Welfare Corporation Limited.

PSEs with Audit Committees are indicated in **Appendix 22**. Out of 35 PSEs, the Audit Committee of 11 PSEs did not evaluate the internal financial control systems, 14 PSEs did not review and monitor the Statutory auditors' performance and effectiveness of audit process, seven PSEs did not review financial statements and auditors' reports, 14 PSEs did not review the findings of CAG and examine the management letters issued by CAG, and 24 PSEs 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.

3.5 Other Committees

3.5.1 Nomination and Remuneration Committee

Section 178(1) of the Companies Act 2013 and Rule 6 of the Companies (Meetings of Board and its Powers) Rules, 2014 stipulate that each PSE shall constitute a Nomination and Remuneration Committee comprising at least three directors, all of whom should be non-executive directors and at least half of them shall be independent directors. Chairman of the committee shall be an independent director. The role of the Nomination and Remuneration Committee is to determine the framework and the policy on the terms of engagement (including remuneration) of the chairman, executive directors and each member of the board. Out of 38 public companies, 17 companies satisfied the criteria of constituting nomination and remuneration committee. Out of 17, nine companies³⁷ did not comply with the requirement.

3.5.2 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 the 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. Audit observed that 12 companies³⁸ formed whistle blower mechanism till 2022-23.

³⁷ Kerala Agro Machinery Corporation Limited, Kerala Feeds Limited, Kerala Irrigation Infrastructure Development Corporation Limited, Kerala State Development Corporation for Christian Converts from Scheduled Castes and the Recommended Communities Limited, Kerala State Electricity Board Limited, Kerala State Handloom Development Corporation Limited, Steel Industries Kerala Limited, The Kerala Ceramics Limited and The Kerala State Coir Corporation Limited.

³⁸ Bekal Resorts Development Corporation Limited, Kerala Small Industries Development Corporation Limited, Kerala State Beverages (Manufacturing and Marketing) Corporation Limited, Kerala State Electricity Board Limited, Kerala State Industrial Development Corporation Limited, Kerala State Power and Infrastructure Finance Corporation Limited, The Kerala Minerals and Metals Limited, The Kerala State Civil Supplies Corporation Limited, The Kerala State Financial Enterprises Limited, Traco Cable Company Limited, Travancore Titanium Products Limited, Kerala Transport Development Finance Corporation Limited.

3.6 Internal Audit Framework

3.6.1 Role of Internal audit

The Institute of Internal Auditors (IIA) defines Internal Auditing as : “An independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. The internal audit activity helps an organisation to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes”. Accordingly, the role of internal audit is to provide independent assurance that an organisation’s risk management, governance and internal control processes are operating effectively.

The framework governing internal audits issued by ICAI defines internal audit as an independent assurance in the effectiveness of internal controls and risk management processes to enhance governance and achieve organisational objectives.

3.6.2 Legal Framework

Section 138(1) of the Act, 2013 read with the Rule 13 of Companies (Accounts) Rules, 2014, provides that (a) every listed company; (b) every unlisted public company having paid up share capital of rupees fifty crore or more; or turnover of rupees two hundred crore or more during the preceding financial year; or outstanding loans or borrowings from banks or public financial institutions exceeding rupees one hundred crore or more; or outstanding deposits of rupees twenty-five crore or more at any point of time during the preceding financial year; (c) every private company having turnover of rupees two hundred crore or more during the preceding financial year; or outstanding loans or borrowings from banks or public financial institutions exceeding rupees one hundred crore or more at any point of time during the preceding financial year shall be required to appoint an internal auditor, who shall either be a chartered accountant or a cost accountant or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company. The internal audit activity helps an organisation 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 the 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.

The details of 49 companies were received for review of internal audit framework.

Audit noticed that out of 49 companies, 10 were required to appoint internal auditor and all the companies complied with the requirements. Internal audit in nine companies was conducted by the Chartered accountant firms and in remaining one company the same was conducted by internal auditors.

3.6.3 Frequency and Reporting of Internal Audit

Section 138(2) of the Act, 2013 provides that the Central Government may, by rules, prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board.

Audit, however, noticed that no rules have been prescribed so far in this regard (March 2023) and hence the internal audit in SPSEs was conducted on quarterly, half-yearly and annual basis. Five PSEs reported quarterly, three PSEs reported half yearly and one PSE reported annually.

Further, nine companies³⁹ reported the internal audit findings to the Board.

3.7 Reply of Government

The Government replied (July 2024) that issues pointed out in the Report are under due consideration of the Government and necessary instructions/directions would be issued to Departments and PSEs to expedite action to settle the issues and adhere to the provision of necessary Act and Statutes in a timely manner.

3.8 Conclusion

During 2022-23, 20 out of 97 companies did not conduct the mandatory four meetings of the Board of Directors. Out of 17 companies that met the criteria, 11 did not appoint independent directors. Out of 101 PSEs, 66 did not constitute Audit Committee. Out of the remaining 35 PSEs, the Audit Committee of 11 PSEs did not evaluate the internal financial control systems, 14 PSEs did not review and monitor the Statutory auditors' performance and effectiveness of audit process, seven PSEs did not review financial statements and auditors' reports, 14 PSEs did not review the findings of CAG and examine the management letters issued by CAG and 24 PSEs 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.

3.9 Recommendations

- 1. Government should ensure that regular meetings of Board of Directors are held as per the provisions of the Companies Act, 2013 and 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.*
- 2. The Finance Department, in co-ordination with respective administrative ministries/departments, should monitor compliance to applicable provisions, rules and regulations on Corporate Governance by all State Public Sector Enterprises (SPSEs).*
- 3. 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.*

³⁹ Cochin Smart Mission Limited, The Kerala State Backward Classes Development Limited, Kerala State Industrial Development Corporation Limited, Kerala State Textile Corporation Limited, Kerala Transport Development Finance Corporation Limited, Malabar Cements Limited, Roads and Bridges Development Corporation of Kerala Limited, The Travancore-Cochin Chemicals Limited and Traco Cable Company Limited.