**May, 2022**

# ACTS AND OMISSIONS

M. Damodaran
*Chairperson, Excellence Enablers*
*Former Chairman, SEBI, UTI and IDBI*

*There are laws that have some of their prescriptive elements either removed or reduced in rigour. There are also laws that bring in additional prescriptions. We focus on one from each category.*

When it rains, it pours. For students of corporate law, March, 2022 was a very productive month, with the Company Law Committee (CLC or the Committee) having submitted its third Report, and the Standing Committee on Finance, presenting its Report on "The Chartered Accountants, The Costs and Works Accountants and the Company Secretaries (Amendment) Bill 2021" (the Bill).

The CLC was set up on September 18, 2019, to make recommendations *inter alia* on changes aimed at facilitating and promoting greater ease of doing business in India. In its preface to the Report, the Committee has stated that the avowed objective of the Central Government is to promote greater ease of doing business for law abiding corporates in the country. This will take some digesting, since the common belief is that laws are written to ensure that those who cannot regulate their own conduct, are persuaded to do so for fear of penal consequences.

The composition of the Committee merits some comment. In addition to the Chairperson, and the Member Secretary, both of whom are career bureaucrats, the Committee comprises a number of lawyers and finance sector professionals. It has less than the desired representation from industry, which is important since onerous laws do not pinch the service providers, but those required to adhere to legal provisions.

In Chapter 1 of the Report, the Committee has made recommendations regarding 24 different aspects impacting on governance. Some of these are clarificatory, and are not being examined herein. Constraints of space would require us to focus on the essentials, more with a view to recognising the thought processes that might go into the framing of corporate laws.

Facilitating some companies to communicate with their members only in electronic form is one of the recommendations. This recommendation reportedly flows out of feedback obtained from stakeholders. The Committee has recognised that totally dispensing with physical communication might not be feasible, but the two reasons given are not very persuasive. The first of these is that members and shareholders might not have provided their electronic mailing (email) address. Obtaining such addresses from persons, who have such mailing address, should not be an insurmountable task. The second reason is that some shareholders might not have converted their securities into demat form. This does not merit serious comment since communication to email addresses does not depend on whether a shareholder has dematerialised his/her shares. The more basic difficulty in moving entirely to communications only in electronic form is that India has not yet overcome its digital divide. Financial inclusion, involving *inter alia* communication between corporates and their members does not have the luxury of waiting for everyone to be comfortable with this form of communication. In moving towards making it adequate to provide documents only in electronic mode, the Committee has taken into account the fact that where a member has requested the company to provide physical documents, the company shall, as an investor friendly measure, also provide such documents in physical mode. This would appear to be a subject that has gone around in circles, without arriving at a final destination.

In regard to fractional shares, Restricted Stock Units (RSUs) and Stock Appreciation Rights (SARs), the Committee has rightly noted that RSUs and SARs should be recognised under the Companies Act, 2013 (the Act), through enabling provisions. As for fractional shares, the recommendation would appear to be premised on practices obtaining in some other jurisdictions. While fractional shares, arising out of corporate action such as mergers, cannot be wished away, it would seem unreasonable to allow for fractional shares merely because the price per share is at such a high level as might not allow retail investors to invest in certain companies. The obvious solution for companies which wish to bring in small retail shareholders is to go for stock splits, rather than to allow fractional shares.

One recommendation which directly goes to the ease of doing business is the proposal to replace affidavits with self-declarations. This would be a welcome move towards a “trust, but verify” approach to dealing with business.

On account of Covid derived difficulties, the Ministry of Corporate Affairs (MCA) had allowed general meetings to be convened through video-conferencing or other audio-visual means (OAVM). Responding to representations made by companies and shareholders, the MCA had extended the applicability of the relaxations to Annual General Meetings (AGMs), and also permitted “hybrid meetings”, thereby allowing flexibility for members to attend meetings either physically or virtually. Having considered the various options, the Committee has recommended that the provisions of the Act should be amended to enable the Central Government to prescribe the manner in which companies can hold AGMs and Extraordinary General Meetings, physically, virtually and in hybrid mode. The Committee need not have stopped at this. It could have gone on to recommend the proposed procedures and safeguards, so that another round of application of mind could have been avoided. The fact however cannot be wished away that physical meetings are far more productive in terms of the nature of interactions among the different constituents, and in promoting a sense of fellow feeling and shared ownership.

Strengthening the National Financial Reporting Authority (NFRA) is another important area that the Committee has addressed. After taking note of the powers available with other Regulators, such as RBI, SEBI, IRDAI and PFRDA, the Committee recommended *inter alia* that NFRA should be enabled to make regulations for matters relating to the filing of information with NFRA, and the detailed procedure to be followed for meetings of the NFRA. In an interesting defensive observation, the Committee has mentioned the following – "However in accordance with principles of good governance and accountability followed by the Central Government, such powers should be sufficiently encumbered with safeguards". This one sentence has several problems. Firstly, having set up a new Regulator with much fanfare, the Government should proceed on the assumption, rebuttable as it might be, that the Authority would act in accordance with the principles of good governance and accountability. The expression "encumbered with safeguards" would seem to imply that safeguards are obstacles, and not guardrails, to retain persons and companies on the straight and narrow path.

In the context of strengthening the NFRA, the Committee has taken note of the jurisdiction of the NFRA in regard to different classes of companies, and expressed the view that "differing classes of companies may be permitted to avail differing non-audit services from their auditors". Accordingly, the Committee recommended that Section 144 of the Act may be amended to enable the Central Government to prescribe "a differential list of prohibitions on availing non-audit services or total prohibition of the same for such class or classes of companies where public interest is inherent". This classification defies understanding. Further, permitting the availing of non-audit services, whether from statutory auditors or from "network firms", is a retrograde step, and undermines the avoidance of conflict of interest.

One long overdue recommendation relates to the recognition of, and the provision of an enabling framework for the constitution of Risk Management Committees (RMCs). It is gratifying that close to a decade after the Act came into existence, RMCs are sought to be given mandatory legitimacy, and are not treated as lesser committees, since they owe their existence to Regulations, rather than to statute. This is a cause that Excellence Enablers has been advocating for the last several years.

To say that this Report is an instance of the mountain going into labour, and producing a mouse, would be an exaggeration. Yet, the Report leaves several significant areas unaddressed. In the light of recent instances of Independent Directors (IDs) being held to account for executive errors, the nature of protection available to IDs should have been addressed. Section 149(12) of the Act provides only a fig leaf of protection. It is confined to instances of acts or omissions relating to the responsibilities cast on Directors by the Act. Experience has shown that many of the charges or accusations against Non-Executive Directors, including IDs, relates to offences under other enactments. This can be addressed if the words "or any other laws for the time being in force", are inserted after the words "notwithstanding anything contained in this Act". Such a provision exists in several other enactments, and there is no reason why the Companies Act, 2013 should not get similar treatment.

One of the offences which the Act seeks to address is the offence of fraud. There is no definition of fraud in Section 2 of the Act, which contains all the important definitions. Section 447 of the Act deals with the punishment for fraud. In the first explanation to

this Section, fraud has been defined, albeit in a very complicated manner. It is strange to find the provision for punishment preceding the definition of the offence to which the punishment relates. This is one instance of cleaning up which could have been attempted.

Strengthening the audit framework is one of the major areas addressed by the Committee. In the context of the resignation of auditors, the Committee has rightly recommended the "resigning auditor to assure the shareholders and other stakeholders that, in her opinion, there is nothing in the company's accounts which needs to be brought to their notice, and that her resignation is an independent decision". We have been of the opinion, for quite some time, that the resigning auditor must personally appear at the AGM subsequent to the resignation, and explain to the shareholders why he/she felt it necessary to resign. The advantage of a personal appearance before the shareholders is that the shareholders can be facilitated to ask questions relating to the resignation, and satisfy themselves. It is with these additional requirements, which are more substantive, than procedural, that the shareholders, and other stakeholders, will have a high level of confidence in the reports presented by the auditors. The Committee seems to have thought it fit to recommend the standardisation of qualifications by the auditors. Standardisation might not capture the specifics of a situation, and might be a defensive template that the Institute of Chartered Accountants of India (ICAI) puts out for its members. What would have been at least as important is for the Committee to look at the standard disclaimers, which are a part of the audit report, and to see whether some of those could have been whittled down, to give more confidence to the shareholders and other stakeholders, in the contents of the audit report. It is also curious that the recommendation regarding standardisation envisages the introduction of a format for auditors by the Central Government. If dissatisfaction with the ICAI is the possible basis for this observation, the NFRA could have been tasked to address this requirement.

Even a casual student of corporate law is aware of the Satyam fraud having led to the inclusion of Schedule IV in the Act. It is high time to shrink the size of Schedule IV, and make it more meaningful, and less repetitive. Further, evaluation of the Board has been wrongly placed, almost as an afterthought, in the portion of Schedule IV dealing with meeting of IDs. Having regard to its importance, Board evaluation merits a separate, and less prescriptive presence, in the main body of the Act, and not in a Schedule thereto.

Will this Report, even if all its recommendations are accepted, significantly contribute to improving the ease of doing business? Will this help to transform the doubting Thomases and the naysayers into believing that businesses and businessmen should be the recipients of a reasonable amount of trust, so that they can contribute to the nation's progress and economic development? The answer to this could have been in the affirmative if the "felt needs" of Chief Executives and Chief Financial Officers had been captured, through the mechanism of their being a part of the Committee.

The Chartered Accountants, The Costs and Works Accountants and the Company Secretaries (Amendment) Bill 2021" (the Bill), as it then was, has understandably provoked scathing comments and significant resistance. A few of those belonging to the universe proposed to be regulated by this Bill, more particularly the fraternity of Chartered Accountants, have resorted to diatribe, bordering on the distasteful, in

commenting on some of the provisions of the Bill. Their entire case seems to be founded on the merit that they see in self-regulation. A recent editorial in a professional journal states – “There is nothing wrong in self-regulation so far as there is transparency, speed, (and) an appeal mechanism”.

The history of self-regulation in India does not inspire confidence. The Medical Council of India, the Dental Council of India, and several other self-regulatory bodies, have on occasions, been found to be not just unable to do what they were tasked to do, but also allegedly complicit in the transgressions of some members. Nothing can be said about the Bar Council of India since lawyers, who are its members, are officers of the Court, and to comment adversely on them, could amount to foolhardiness.

Chartered accountancy is a respected and a coveted profession. For decades, the conduct of the members of the profession has been regulated by the ICAI. This is never an ideal solution, since membership bodies cannot be ideal Regulators. It is in recognition of this fact that the New York Stock Exchange, which had its own regulatory wing, moved it away, to be subsumed in the Financial Industry Regulatory Authority (FINRA). Membership bodies are legitimately expected to protect the interests of the members, and it would be against the grain for a few of them to be constituted into a disciplinary body, to sit in judgement on members like themselves. The thought that “there, but for the grace of God, go I”, cannot often be far from their minds, when considering the guilt or innocence of a fellow member, or in deciding the quantum of punishment. The NFRA was set up only because there were enough instances of the guilty not having been pulled up quickly enough, and punished adequately. Where the Government however seems to be erring is in the proposed composition of the Indian Institutes of Accounting (IIA), with a coordinating role being vested in that body. Setting up new institutes is often the easiest solution, but not the most desirable. It would have been preferable to further strengthen the NFRA, and to give it the capacity and the bandwidth to be the apex Regulator of the auditing profession. The stated purpose of setting up the IIA is to further the development of the accounting and the finance profession in the country. However, the problem lies in the proposed Coordination Committee, with a plethora of functions, which will sooner, rather than later, translate to the exercise of controls that could be in conflict with the powers of the disciplinary bodies. The fact that the Company Secretaries and the Cost Accountants have not objected to the proposed Coordination Committee, does not strengthen the case for setting up yet another body.

It is no one’s case that the 3 professions covered by this legislation need to be better regulated to ensure that public confidence in the gatekeepers of governance is not eroded. However, the answer lies in strengthening existing institutions, and not in setting up newer institutions, with powers and functions that could have an overlap with those of existing institutions.

One of the fundamental provisions is that for the misconduct of a partner, the entire firm should be made liable. In theory, this is a good proposition. However, this could usher in the problem of unintended consequences, with a large number of partners being exposed to disqualification or punishment, if any one partner is seen to step out of line.

The philosophy of the Central Government stepping in directly to set right the wrongs that have taken place, is a solution that could generate its own problems. One need not

endorse, in its entirety, the criticism in the editorial referred to earlier. However, no harm would be done if some of the reservations expressed therein are taken on board, and agreed solutions found.

There was a time, not too long ago, when it used to be said " Give me a problem and I will give you a solution." Is "I will give you an institution" the default option now, for responding to problems?


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*Do let us know of any specific issues you would like to see addressed in subsequent issues.*

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