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Ministry of Corporate Affairs
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BOARD EVALUATION

The Companies Act, 2013 codifies the duties of directors, and specifies that the director of a company shall act in accordance with the articles of the company. It is further provided:

- A director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.
- A director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.
- A director of a company shall not involve 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.
- A director of a company shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.
- A director of a company shall not assign his office and any assignment so made shall be void.

The stakeholders and investors are interested to know whether the members of Board are effectively functioning individually and collectively. The Board at many times requires new skills for promptly responding to the dynamic changing business environment. Performance measurement, against the set benchmarks, in the form of Board evaluation (also called "Board assessment", "Board review") has the potential to significantly enhance Board effectiveness, maximize strengths, tackle weaknesses and improve corporate relationships. Annual assessment is a powerful tool to convert good boards into great boards.

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KEY HIGHLIGHTS

Need for board evaluation

The purposes of the Board evaluation can be enumerated as under:

- Improving the performance of Board towards corporate goals and objectives.
- Assessing the balance of skills, knowledge and experience on the Board.
- Identifying the areas of concern and areas to be focussed for improvement.
- Identifying and creating awareness about the role of Directors individually and collectively as Board.
- Building Team work among Board members.
- Effective Coordination between Board and Management.
- Overall growth of the organisation.

Appraisal of Board's performance includes fixing up of individual and collective roles and responsibilities of its directors, creating awareness among Directors about their expected level of performance and thereby improving the effectiveness of the Board. Board evaluation contributes significantly to improved performance at three levels - organizational, Board and individual Board member level. It also improves the leadership, teamwork, accountability, decision-making, communication and efficiency of the board. A commitment to annual evaluation is powerful change agent.

The Board evaluation sets the standards of performance and improves the culture of collective action by Board.

Evaluation also improves teamwork by creating better understanding of Board dynamics, board-management relations and thinking as a group within the board. It helps to maximize board/ director contribution by encouraging participation in meetings and highlighting the skill gaps on the Board and those of individual members. Directors demonstrate commitment to improvement, based on the feedback provided on individual and collective skill gaps.

Even beyond the legal mandate many good governed companies have been undertaking evaluation of its Board.

Legal Framework

The Companies Act, 2013 (the Act) now mandates formal annual evaluation of the Board, its committees and individual directors.

Section 134 of the Companies Act, 2013 *interalia* specifies the contents that are required to be part of Board's Report.

According to Section 134 sub-section 3(p) read with Sub-rule (4) of Rule 8 of the Companies (Accounts) Rules, 2014 every listed company and every other public company having paid- up share capital of twenty five crores or more calculated at the end of the preceding financial year should include in the report by its Board of Directors, a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors.

Requirements under schedule IV

The Schedule IV, *i.e.,* "Code for Independent Directors" provides that independent directors shall bring an objective view in the evaluation of the performance of Board and management.

The independent directors of the company shall hold at least one meeting in a year, without the attendance of non-independent directors and members of management. All the independent directors of the company shall strive to be present at such meeting. The meeting shall:

(a) review the performance of non-independent directors and the Board as a whole;

(b) review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;

(c) assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

Role of Nomination & Remuneration Committee in Board Evaluation

Nomination & Remuneration Committee constituted under section 178 of the Act has been made responsible for carrying out evaluation of every director's performance.

Section 178(2) states that the Nomination and Remuneration Committee shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal and shall carry out evaluation of every director's performance.

It is pertinent to note that for the smooth and timely evaluation, the Nomination and Remuneration Committee plays a crucial role starting from developing the questionnaire to overseeing the evaluation and finally analyzing the feedback.

Frequency of Board Evaluation

Reading section 134(3)(p) it can be inferred that there has to be a formal annual evaluation of Board of its own performance and that of its committees and individual directors.

The Company may undertake annual evaluation either in accordance with calendar year or financial year, as there is no clarity on this. Ideally, the same should be as per financial year.

Review : This evaluation methodology may be reviewed once in a year by the Nomination and Remuneration Committee based on the recommendation of the Board and/or to ensure compliance with regulatory requirements.

Post Disclosure : Apart from disclosures in the Boards' Report, follow-up is critical for having the maximum impact. Once the evaluation is complete, directors should be encouraged to formally recognize the results and enable follow-up activities. Follow up should include developing a plan of action for addressing points that arise from the discussion and assigning follow-up responsibilities to the governance committee, if any or the Board Chair. This may include :

- Communication to individual director - the feedback or concerns may be shared with directors preferably by the Chairperson in a delicate and subtle manner in one to one meeting. Such meetings should be interactive so that cordial future action can be derived.
- Systemic changes can be introduced which shall include director development programmes, director dashboard, better information flow to directors, committees etc.