Boards need to understand each other in terms of values, beliefs, and purpose. This session is "Evaluating Board Performance," a formal evaluation of the Board and individual directors are one potentially effective way to respond to the demand for greater board accountability and effectiveness.

Section 134(3)(p) of the Companies Act, 2013 (the Act) read with Clause 49 (l)(D)(2)(i) of the Listing agreement mandates Board's performance evaluation for every listed company. Further the said evaluation is required to be carried out by public companies whose paid-up capital is twenty five crores or more calculated at the end of preceding financial year. The Evaluation has to be done every year as the Act has clearly laid out that the re-appointment of Independent Directors as laid out in Point No. VIII of Schedule IV - Code for Independent Directors read with Clause 49(l)(B) Explanation (5).

The Extracts from Companies Act, 2013 and Listing Agreement necessitating for Board's performance evaluations is listed out here under:

**Under Companies Act, 2013:**

- Section 134(3)(p) - Financial statement, Board's report - In case of a listed company and every other public company having such paid-up share capital as may be prescribed, 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 shall be included in the Board's report.

- Section 178(2) - Nomination & Remuneration & Stakeholders Relationship Committee: The Nomination and Remuneration Committee shall carry out evaluation of every director's performance.
Schedule IV - Code for Independent Directors - Under the role and function of Independent Director, it is mentioned that the independent director shall bring an objective view in the evaluation of the performance of Board and management.

Schedule IV - Code for Independent Directors - Point No. V provides for re-appointment of Independent Director, it is mentioned that the re-appointment of independent director shall be on the basis of report of performance evaluation.

Schedule IV - Code for Independent Directors - Point No. VIII provides for evaluation mechanism, it is mentioned that the performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated. (2) On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director

Under Listing Agreement

Clause 49 (I)(D)(i) - It specifies that the Board should fulfill certain key functions including Monitoring and reviewing Board evaluation framework.

Clause 49(II)(B) Explanation (5) - Provides for performance evaluation of Independent Directors as follows:

a) The Nomination Committee shall lay down the evaluation criteria for performance evaluation of independent directors.

b) The company shall disclose the criteria for performance evaluation, as laid down by the Nomination Committee, in its Annual Report.

c) The performance evaluation of independent directors shall be done by the entire Board of Directors (excluding the director being evaluated).

d) On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.

Role of Nomination and Remuneration Committee: -

The role of the committee shall, inter-alia, include the following:

1. Formulation of the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration of the directors, key managerial personnel and other employees;

2. Formulation of criteria for evaluation of Independent Directors and the Board;

3. Devising a policy on Board diversity;

4. Identifying persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend to the Board their appointment and removal. The company shall disclose the remuneration policy and the evaluation criteria in its Annual Report.
WHO SHOULD BE EVALUATED?

The following persons are required to be evaluated:

1. The Board - Section 134(3)(p)
2. Independent Directors - Clause 49(II)(B) Explanation (5).
3. The Committee Members - Section 134(3)(p)
4. All the directors – Executive & Non-Executive - Section 134(3)(p) read with 178(2)
5. The Chairman - Best Practices
6. The CEO – Best Practices

WHO CAN DO BOARD PERFORMANCE EVALUATION?

The following can carry out a Board performance evaluation:

1. Nomination & Remuneration Committee - Section 178(2)

2. The Board of Directors - Schedule IV - Code for Independent Directors Point No. VIII read with Clause 49(II)(B) Explanation (5).

3. External evaluator – Best Practices

WHY BOARD’S PERFORMANCE EVALUATION?

Board’s performance evaluation is required for following reasons:

a. It is mandated under Companies Act 2013 and the Listing Agreement

b. Point V & VIII of schedule IV of the Act and clause 49 of the listing agreement makes it mandatory to do a performance evaluation of the Board and the re-appointment of a director is based on such evaluation.

c. The entire evaluation process has to be disclosed in the Annual report.

PENALTY - CAUSE & EFFECT

1. The Independent Directors cannot be re-appointed unless performance review is done Clause 49(II)(B) Explanation (5).

2. The Compensation of the executive directors is based on the evaluation mechanism and the onus is on the Independent directors

3. In case a company fails to do performance evaluation and does not report in the Board’s Report as prescribed in section 134(3)(p) - Financial statement, Board's report.
The penalty for not carrying out an evaluation and reporting is as follows:

**Penalty under Section 172 of Companies Act (not complying with Schedule IV requirement)**

If a company contravenes any provisions of this chapter, and for which no specific punishment is provided therein, then the company and every officer of the company who is in default shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees.

**Penalty under Section 134 of Companies Act (not complying with reporting requirement in Board’s Report)**

If a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to twenty five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

**Penalty under section 15HB of SEBI Ac for contravention where no separate penalty has been provided (not complying with listing agreement)**

Whoever fails to comply with any provision of this Act, the rules or the regulations made or directions issued by the Board thereunder for which no separate penalty has been provided, shall be [liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.]

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**Recommended Read**

- Appointment of a Nominee Director by the Board - Some legal perspectives
- Code of conducts under Insolvency and Bankruptcy Board of India Regulations, 2016

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**Comments**

- SMITHA SINGH
  - Superb article. Thanks
  - Reply
  
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