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Corporate Governance

Nepal
Sinha-Verma Law Concern (SVLC)

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Law and Practice

Contributed by Sinha-Verma Law Concern (SVLC)

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Sinha-Verma Law Concern (SVLC) has established itself as one of the leading corporate law firms of Nepal. The firm is managed by Advocate Mr Mahesh Kumar Thapa, the managing partner, and has a team of dedicated and experienced lawyers and support staff. The dynamic and versatile team of lawyers of SVLC provide multi-disciplinary expertise in

various fields, including dealing with commercial litigation and other commercial issues such as taxation, corporate law, foreign investment and employment law. The firm has always strived to serve the best interests of domestic as well as international clients.

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1. Introduction

1.1 Forms of Corporate/Business Organisations

The principal forms of business organisations include proprietorship (private) firms, partnership firms, co-operatives and limited liability companies under the laws of Nepal. Limited liability companies are incorporated as:

- private limited companies;
- public limited companies; or
- companies not distributing profit.

Additionally, public companies can be further divided into listed and non-listed companies. Similarly, a foreign company is another typical form of business organisation in

Nepal and it can be a joint venture company or a fully owned subsidiary.

1.2 Sources of Corporate Governance Requirements

The principal sources of corporate governance are articles of association, memoranda of association, any existing agreements between the promoters and the prospectus of the company. The other sources of corporate governance are decisions made by the board of directors (BoD), decisions made in the general meetings of the company and any other decisions made to regulate office affairs. Similarly, the Companies Act, the Bank and Financial Institution Act, the Foreign Investment and Technology Transfer Act, bylaws,

directives, policies and circulars issued from the concerned authorities significantly provide for corporate governance.

1.3 Corporate Governance Requirements for Publicly Traded Companies

Corporate governance requirements for publicly listed companies are mainly defined in the laws and documents mentioned above and by the Securities Board of Nepal. The following are the requirements of corporate governance for companies with publicly traded shares.

- A board member cannot work as an auditor, adviser, surveyor, broker or agent of insurance companies or as a staff member in other organisations.
- Listed companies must make public their financial condition on a regular basis. If more than one member of a single family has to be appointed to the board, the company needs to mention this in its annual report.
- Board members can serve for a maximum of four years.
- Board members are forbidden from working in other organisations. If found to do so, they are subjected to punishment and disqualified from becoming a director, general manager or an office equivalent thereto in any public limited company or a body for a period of up to ten years from the date of such punishment.
- Any person convicted of financial irregularities cannot hold the position of board member or chief executive officer (CEO) of listed companies for at least ten years.
- An individual is barred from holding the positions of both chairman and chief executive officer of the same company.
- Listed companies need to form a separate risk management committee to assess and minimise possible risks.
- An internal control mechanism should be developed to look after possible financial irregularities.
- Listed companies need to form a three-member independent audit assessment committee to look after the audit system.
- A body corporate is required to give a notice along with the details of securities where a body corporate allots or sells securities after registration.
- Any listed company must work in the interests of its members. Otherwise, the board takes against such pre-convicted act.
- A body corporate shall have to register securities to be issued by it with the board prior to their issuance.
- The corporate governance framework must comply with all the laws, rules and regulatory requirements.
- There is a requirement for equal treatment to all shareholders and maintaining accountability and transparency besides making public vital information about the companies.
- The government of Nepal may issue necessary directions to the board from time to time, in respect of policy matters such as the development of capital markets and

protection of the interests of investors, and it shall be the duty of the board to comply with such directions.

- A listed corporate body is required to act in good faith and shall not be personally liable for any act done or taken in good faith.

The requirements are mandatory.

2. Corporate Governance Framework

2.1 Key Rules and Requirements

Major corporate governance rules are as mentioned above and other than those there are no other significant rules to be mentioned.

2.2 Current Issues and Developments

The typical issue in Nepalese corporate governance is a lack of transparency and accountability. Unless the law mandates with penalty for failure, the management may not disclose the corporate information that in normal cases would have to be disclosed. Most of the businesses are under the control of closely held companies and the management of such companies would hardly witness the corporate governance.

With the presence of multinationals, local public companies are also joining the disclosure culture but not yet fully. Banks and financial institutions and insurance companies are relatively good in the area of governance.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

The principal bodies involved in corporate governance include the board of directors, the general meeting of shareholders and certain committees.

For a public company meeting, it shall send a notice specifying the place, date and agenda of the meeting to every shareholder at the address supplied by that shareholder to the company, at least 21 days before an annual general meeting, and at least 15 days before an extraordinary general meeting. A notice thereof shall also be published at least twice in a national daily newspaper.

An audit committee should be formed from amongst the auditors licensed to carry out an audit under the prevailing law. A listed company with paid-up capital of NPR30 million or more or a company that is fully or partly owned by the government of Nepal shall form an audit committee under the chairpersonship of a director who is not involved in the day-to-day operations of the company and consisting of at least three members.

Other than the audit committee, which is a mandatory requirement for public companies as mentioned above, the BoD may constitute different committees or sub-committees to assist the BoD in decision-making processes or the implementation thereof, or for any other day-to-day function of the company.

3.2 Types of Decisions Made by Governing Bodies Board of Directors

The BoD is the executive body involved in overall governance and management of the company. Under the general mandate from the shareholders in the form of resolutions passed in meetings or a shareholders agreement, the BoD takes all administrative decisions in the company.

However, a BoD of a public company receiving loans needs a special resolution adopted by the general meeting to perform acts like borrowing, selling, donating, leasing, and making a gift, etc of the property where more than 70% of one or more undertakings are operated by it.

Shareholders

Shareholders shall give their opinion or decide in every matter put to the vote. The following are the matters presented to decide:

- financial statements as audited, auditor's report and directors' report;
- any matters as requested to be presented in the general meeting; and
- matters related to the distribution of dividends, the appointment of directors and their remuneration, auditor appointment and his remuneration, and articles of association to be decided by the AGM.

Audit Committee

The audit committee formed has the following responsibilities:

- to review the accounts and financial statements of the company, and ascertain the truth of the facts mentioned in such statements;
- to review the internal financial control system and the risk management system of the company;
- to supervise and review the internal auditing activity of the company;
- to recommend the names of potential auditors for the appointment of the auditor of the company, fix the remuneration and terms and conditions of appointment of the auditor, and present the same in the general meeting for the ratification thereof;
- to review and supervise as to whether the auditor of the company has observed such conduct, standards and directives determined by the competent body pursuant to the prevailing law as required to be observed in the course of doing auditing work;

- to formulate the policies required to be observed by the company in respect of the appointment and selection of the auditor;
- to prepare the accounts-related policy of the company and enforce, or cause to be enforced, the same;
- where any regulatory body has provided for the long-term audit report to be set out in the audit report of the company, to comply with the terms required to prepare such report; and
- to perform such other terms as prescribed by the board of directors in respect of the accounts, financial management and audit of the company.

3.3 Decision-making Processes

When a general meeting is called, every matter to be discussed in the meeting is presented in the form of a resolution. The chairperson of the board of directors chairs the meeting and declares whether a resolution has been adopted. In doing so, shareholders present in the meeting vote and decide whether to adopt the resolution presented. However, a special resolution presented in the meeting shall be adopted by the meeting only if 75% of the shareholders present in the meeting vote in favour of the resolution. If votes are evenly divided for and against at a general meeting, the chairperson of the meeting may exercise the casting vote.

4. Directors and Officers

4.1 Board Structure

The directors are elected or nominated by shareholders. Corporate shareholders can only nominate the directors. The board consists of a chairman and members. However, in some companies, there is a managing director and some working directors. The chairman has the deciding vote in board meetings in the event of a tied vote.

Generally, in private companies the appointment and number of directors in the board shall be as provided in its articles of association, whereas in a public company the board shall include 3-11 directors. The tenure for the directors is as prescribed in the articles of association. However, in the case of public companies, the tenure shall not exceed four years.

The Companies Act requires that there must be one or two independent directors depending on the size of the board. If the board comprises up to seven directors, there should be at least one independent director and in the case of more than seven board members, the number of independent directors should be two.

4.2 Roles of Board Members

Directors perform collectively. However, the board may give any specific assignment to a particular director. If the company has working directors, the articles of association may prescribe certain roles to them.

4.3 Board Composition Requirements/ Recommendations

The board is composed of a chairman and other directors. Depending on the requirement of the articles of association or a decision of the board of directors, there may be a managing director and some working directors. In public companies, independent directors are required in a given ratio as mentioned above.

4.4 Appointment and Removal of Directors/ Officers

Matters regarding the appointment and removal of the director and company secretary are required to be included in the articles of association. Details such as the name, occupation, date of appointment, date of removal, etc of the director and the company secretary are required to be maintained by the company in a separate register.

If the first annual general meeting is yet to be held, the directors are appointed by the promoters of the company or directors are generally appointed by the general meeting. The directors so appointed can appoint one managing director among themselves. However, if the office of the director so appointed is vacated for any reason, the board of directors appoints another director in that vacant position. Corporate shareholders may be allowed to nominate directors in the board.

Every private company having paid-up capital of more than NPR10 million and public company has to appoint a company secretary. A person who is qualified as per the law is appointed as the secretary of the company by the board of directors. The details of the secretary so appointed is then given to the Office of Company Registrar.

The board of directors usually fills the CEO, chief financial officer and other vital officer positions.

The director of a company can be removed from the office if he or she is disqualified to hold the office of director. There may be various reasons for the disqualification, such as being convicted of an offence of corruption or theft, fraud or failing to submit the reports required to be submitted, etc. In the case of an independent director, he or she may be removed from the office if he or she is a shareholder of the concerned company.

Any shareholder or shareholders who represent at least 5% of the total shares of the company who are entitled to vote initiate the process of removal of a director from their office by submitting a notice of such proposal along with the basis and reason for removal 30 days prior to the date of the general meeting. The board of directors cannot submit such proposal by themselves. Upon receiving the proposal, it is included in the agenda to be discussed. The director in question is given

the opportunity to defend themselves before the decision is taken.

Besides the director and company secretary, the company must also appoint an auditor from auditors licensed to carry out an audit and a liquidator, in case the shareholders decide to liquidate the company. The auditor as well as the liquidator can be appointed by the general meeting. In the case of a private company, the auditor can be appointed as per the memorandum of association, articles of association or consensus agreement. However, if the general meeting fails to appoint the auditor, the Office of Company Registrar can appoint the auditor at the request of the board of directors.

The liquidator so appointed by the shareholders through a general meeting has to act as per the insolvency professional code of conduct, for the company's interest and according to the prevailing laws. If the liquidator fails to do so then the liquidator shall be removed through the same process of appointment. However, the opportunity should be given to the liquidator to defend himself or herself.

4.5 Independence of Directors and Conflicts of Interest

When the directors of a company have personal interests and involvement in any matters of the company, or its subsidiary or holding company, then not only would it affect the corporate governance but it would obstruct them from working independently for the interests of the company as well. Thus, directors having personal concern or interest in any matter to be discussed in a meeting of the board of directors are not allowed to take part in the discussion and vote on the matter.

Furthermore, to ensure that there is no potential conflict of interest between the director that is appointed and the company, the directors disclose various matters, such as whether they or any of their close relatives have direct involvement or any personal interest in the transactions of the company, or have interests in the appointment of managing directors or officers of the company, or if they hold the position of director of another company, or other matters that would give potential rise to conflict of interest in the future. Such matters are disclosed by the directors within 15 days of their appointment to the office of director.

Every public company or private with paid-up capital of NPR10 million or more or with an annual turnover of NPR10 million or more is required to prepare a separate report of the board of directors stating the details of disclosures made about the personal interests of the director and their close relatives.

4.6 Legal Duties of Directors/Officers

The directors' principal duty is to work for the interests of the company and its shareholders and stakeholders. Thus, they are required to take an oath of honesty and secrecy, and dis-

close any kind of personal interest with the transactions of the company or regarding the shares they hold to avoid any conflict of interest. They must act honestly, reasonably and in good faith in favour of company's benefits and interests. The same goes for the officers of the company, whether it is the company secretary or auditor or liquidator. However, the oath is applicable only for the directors of public companies.

4.7 Responsibility/Accountability of Directors

The main purpose of the directors of the company is to work to meet the interests of the shareholders and to ensure the company's prosperity. Directors cannot do anything to derive personal benefit through the company or in the course of conducting business of the company. Directors are required to take into account the interests of the company as well as its shareholders and stakeholders. While doing so, they shall comply with the applicable laws, memorandum of association, articles of association and the consensus agreement.

4.8 Breach of Directors' Duties

The commercial bench of a court specified by the government of Nepal has jurisdiction to hear cases relating to the breach of duties by directors. A petition can be made in the court by a company or any shareholder of the company or the Office of Company Registrar on the basis of a report submitted by the inspector appointed for an investigation into the breach of duty by the director of the company. Upon receiving such petition, the court can enquire into the concerned company or its director and issue an appropriate order. The director may be ordered to pay a fine or even be imprisoned and if a petition is made claiming remedy then the court can even issue an order in the name of the company to provide an appropriate remedy.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

Officers who give false statements about the actual financial situation of the company are held personally liable. Auditors who breach the code of conduct of auditors or the prevailing laws are removed in the same way they are appointed. On the other hand, any creditor or shareholder of a company that thinks there is an irregularity during the liquidation of the company by the liquidator can make a complaint to the court against the act of the liquidator.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

Any payments given to the directors – whether monthly remuneration, daily allowance or other facility – are determined by the general meeting of the company. However, if the first general meeting is yet to be held, the remuneration or facilities to be provided to the directors are decided by the board of directors. The directors are restricted from giving any loan facility or remuneration from the company contrary to that provided by the law. Besides the remuneration, rewards in sum can be granted by adopting a special

resolution. The remuneration given to the managing director and other directors who take the responsibility of management of the company is determined in their employment agreement.

Other than the payments to the director, the remuneration to be given to an auditor appointed by a company is borne by that company as prescribed by the appointing authority. The audit committee formed in the company can recommend the remuneration of the potential auditors to be appointed. In cases where the company is to be liquidated, the shareholders can appoint a licensed liquidator to conduct the liquidation proceedings and fix the remuneration receivable by such liquidator.

4.11 Disclosure of Payments to Directors/Officers

Companies are required to prepare a report regarding the remuneration and allowance of the directors and officers, apart from a few other disclosures, and submit it to the Office of Company Registrar after having it approved by the board of directors and certified by the auditor of the company.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

The Companies Act defines shareholders as those persons who have ownership in the share of a company. Further, the Act, in defining the 'incorporation of a company', clearly writes that the motive of incorporating any company is to gain profit. Since a corporation is an investment for its shareholders, the basic sense of the relationship existing among companies and shareholders is 'profit' gained from such investment.

In general, the relationship between a corporation and its shareholders depends upon the corporate charter/articles, shareholder agreements and shareholder provisions. However, as soon as a company is incorporated, the memorandum of association and the articles of association of the company regulate the relationship of the shareholders and the company where such shareholders have common rights and a standard relationship to the corporation that they partially own.

5.2 Role of Shareholders in Company Management

When a company is incorporated, shareholders take macro-level company management through a general meeting of shareholders, which is an apex body of a company. The board of directors and officers of the company implement the decision of the shareholders meeting at a micro level. They have the authority to direct the board of directors and the officers as to the way they want the company to be run.

5.3 Shareholder Meetings

It depends on the nature of the company as to whether shareholders meetings are required. A single shareholder company does not have a shareholders meeting as there is only one shareholder. A company having more than one shareholder needs to have shareholders meetings.

Shareholders meetings are classified as an annual general meeting or a special general meeting. An annual general meeting takes place every year, generally within six months from the expiry of each financial year. A special general meeting take place as and when required. It is usually required when there are certain items to be decided by shareholders but the annual general meeting is not due or would be delayed.

When a company is incorporated, it is obliged to hold its first annual general meeting within one year from its incorporation. In the case of a public company, it is within one year from the date the business commencement approval is received.

When calling for an annual general meeting, a notice specifying the place, date and agenda of the meeting to every shareholder should be sent at least 21 days before the meeting. In the case of a public company, the notice should also be published at least twice in a national daily newspaper. The minimum notice period for a special general meeting, which is also called an extraordinary general meeting, is 15 days. The quorum for the meeting of a private company is usually specified in the articles of association, whereas at least three shareholders of the total shareholders representing more than 50% of the total number of allotted shares of the company should remain present in person or by proxy of the public company. If the quorum is not fulfilled, the meeting will be adjourned and such meeting will be called again. The notice period and quorums are flexible for adjourned meetings.

5.4 Shareholder Claims

To Prevent from Performing an Unauthorised Act

If the directors or the company are found doing any unauthorised act, any shareholder can file a petition to the court to prevent such act.

To Ask for an Appropriate Order

Shareholders can file a complaint or petition to the court looking for an appropriate order, if the company fails to perform any act required to be done and it resulted in, or would result in, a prejudice to the rights and interests of any shareholder.

Remedies Available under other Prevailing Laws

Besides the Companies Act, shareholders can apply and claim under any relevant prevailing laws if they suffer any loss or damages because a company or its director or any-

one responsible for the management or control of the company or an employee has committed or omitted any act not required or otherwise carried out discrimination against them.

5.5 Disclosure by Shareholders in Publicly Traded Companies

Shareholders of a public company are required to submit information within 30 days as to in what capacity one has obtained shares with full voting rights registered in his or her name or whether any person has investment in shares registered in the name of such shareholder and where there is another person who is the beneficiary of such shares, the identity and nature of the title of that person.

Similarly, a substantial shareholder of every public company shall give information setting out his or her name, address as well as the full particulars of the shares registered in his or her or an agent's name within 35 days after it becomes known that they are a substantial shareholder of that company.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Annual financial statements, directors' reports and auditor's reports are the basic documents that need to be reported periodically.

6.2 Disclosure of Corporate Governance Arrangements

The financial report so prepared shall contain a true and fair view of the affairs of the company. It must contain an account of the profit and loss along with cash flow in that financial year.

Likewise, the annual financial statement must contain information such as the following:

- a review of last year's transactions;
- the present year's achievement;
- the industrial or professional relations of the company;
- major things affecting transactions;
- remarks of the BoD in the audit reports;
- the amount recommended to pay the dividend;
- details of the forfeited shares;
- financial details of the company and its subsidiary company;
- major transactions completed and any changes adopted by the company and its subsidiary company;
- disclosure made by the substantial shareholders;
- shareholders' details obtained by the directors of the company in the previous financial year;

- personal interests disclosed by the director and his or her close relatives in any agreements related with the company during the previous financial year;
- details of the buyback shares;
- details of an internal control system;
- details of the previous financial year's total management expenses;
- details about the audit committee;
- details of any outstanding amounts payable to the company by any director, managing director, chief executive, substantial shareholder or his or her close relative or by any company, corporate body in which he or she is involved;
- details of any amount of remuneration, allowances and faculties paid to the director, managing director, chief executive and officers;
- details of any dividend amount remaining unclaimed by the shareholders;
- details of the sale and purchase of properties; and
- details of transactions carried on between the associated companies.

6.3 Companies Registry Filings

The following is the information required to be filed to the Office of Company Registrar. However, such information is not publicly available.

- Audited financial statements with the auditor's report.
- Report of the board of directors.
- Inventory of shares and debentures.
- Shareholders registry.
- Directors' registry.
- Company secretary registry.
- Appointment of the statutory auditor.

7. Audit, Risk and Internal Controls

7.1 External Auditors

To have the accounts audited, every company must appoint an auditor satisfying each condition set forth in the Companies Act. The annual general meeting of the company appoints an independent auditor to audit the financial statements of the company. However, if the annual meeting of

the company fails to appoint an auditor for any reason or if the general meeting itself cannot be held or the auditor appointed ceased to continue his or her office for any reason, the office may also appoint an auditor at the request of the board of directors of the company.

7.2 Management Risk and Internal Controls

To Act in Good Faith

Any person appointed as a director of a public company is required to take an oath of secrecy and honesty prior to assuming the duties of his office. Thereafter, while discharging their duties, every person taking an oath of secrecy and honesty is required to act honestly and in good faith, having regard to the interest and benefit of the company, and exercise such care, caution, wisdom, diligence and efficiency as a reasonable and prudent person would exercise.

Not to Derive Personal Benefit

A director is not allowed to do anything through which they could derive personal benefit through the company or in the course of conducting the business of the company. If anyone is found to derive personal benefit, the company shall recover the amount involved as if such amount were a loan.

To Act Within the Jurisdiction

It is the duty of every director and officer to act within the ambit of jurisdiction specified in the memorandum of association and to act in compliance with the Companies Act. Otherwise, a company may recover damages from a person acting in the capacity of director or representative of the company for any loss or damage caused to the company from any act or action done by such person beyond his jurisdiction.

Not to Make Loans to Officers or Shareholders

The BoD always needs to make sure during its course of actions that no loans or financial assistance have been provided to its officers, substantial shareholders or officers, shareholders of a holding company or a close relative of such person, nor has it given any guarantee or provided security in respect of any loan borrowed by such officer or shareholder or close relative from any other person unless it is allowed to do so in accordance with the rules of the company.

To Implement Suggestions Given by the Audit Committee

The board of directors shall implement the suggestions made by the audit committee in respect of the accounts and financial management of the company; and where any suggestion cannot be implemented, the board of directors shall also mention the reasons for the same in its report.

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