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Corporate governance offers a comprehensive, interdisciplinary approach to the management and control of companies. Corporate professionals of today and tomorrow must imbibe in themselves the evolving principles of good corporate governance across the globe on a continual basis. Therefore Corporate Governance has emerged as an important academic discipline in its own right, bringing together contributions from accounting, finance, law and management. Excellence can be bettered only through continuous study, research and academic and professional interaction of the highest quality in the theory and practice of good corporate governance. The corporate world looks upon especially Company Secretaries to provide the impetus, guidance and direction for achieving world-class corporate governance. Company Secretaries are the primary source of advice on the conduct of business. This can take into its fold everything from legal advice on conflicts of interest, through accounting advice, to the development of strategy/corporate compliance and advice on sustainability aspects.

The paper on Governance, Risk Management, Compliances and Ethics has been introduced to provide knowledge on global development on governance, risk management, compliances, ethics and sustainability aspects and best governance practices followed worldwide.

This Paper is divided into four parts: Part I deals with Governance, Part II deals with Risk Management, Part III deals with Compliances and Part IV deals with Ethics & Sustainability.

Part I elaborates on the conceptual and legal framework of Corporate Governance and the role of Board of Directors, promoters and stakeholders. Part II explains about the Risk identification, its management, mitigation and audit. Part III explains the significance of Compliance and essentials of a compliance management program. This part also details about the Internal Control and Reporting. Part IV details about the relation of Ethics and business. This part also explains about Sustainability and approaches to measure Business Sustainability.

The legislative changes made up to September, 2018 have been incorporated in the study material. The students to be conversant with the amendments to the laws made upto six months preceding the date of examination. It may happen that some developments might have taken place during the printing of the study material and its supply to the students. The students are therefore advised to refer to the updates at the Regulator’s website, Supplement relevant for the subject issued by ICSI and ICSI Journal Chartered Secretary and other publications for updation of study material.

In the event of any doubt, students may write to the Directorate of Professional Development, Perspective Planning & Studies of the Institute for clarification at academics@icsi.edu.

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Should there be any discrepancy, error or omission noted in the study material, the Institute shall be obliged if the same is brought to its notice for issue of corrigendum in the e-bulletin 'Student Company Secretary'.
PROFESSIONAL PROGRAMME
GOVERNANCE, RISK MANAGEMENT, COMPLIANCES AND ETHICS

This study material is divided into four parts with following weightage of marks:

Part I – Governance (50 marks)
Part II - Risk Management (20 marks)
Part III - Compliances (20 marks)
Part IV - Ethics & Sustainability (10 marks)

Part I – Governance

Corporate Governance has a broad scope. It includes both social and institutional aspects. Corporate Governance encourages a trustworthy, moral, as well as ethical environment. In other words, the heart of corporate governance is transparency, disclosure, accountability and integrity. In the last decade, many emerging markets, international bodies, governments, financial institutions, public and private sector bodies have reformed their corporate governance systems and are encouraging debate and spearheading initiatives towards good corporate governance. Better regulatory and self-regulatory corporate governance frameworks and enforcement mechanisms are being implemented through tougher legislations and Corporate Governance Codes.

This part of the study apprise about the developments across jurisdictions and brief about the historic origin, need and importance of corporate governance, legislative framework of Corporate Governance explaining the need, scope and evolution of Corporate Governance, Contemporary Developments in Corporate Governance Corporate Governance codes in major jurisdictions, Corporate Governance in Indian Ethos and family enterprises. This part further explains the Board effectiveness, its committees, performance evaluation of Board and role of Promoters.

Part II - Risk Management

Risk is inherent in every business, whether it be of financial nature or non-financial nature. Thus, management of the risk is very important. Risk management begins with the risk identification, analyzing the risk factors, making assessment of the risk and mitigation of the risk. Better risk management techniques provide early warning signals so that the same may addressed in time. In traditional concept the natural calamities like fire, earthquake, flood, etc were only treated as risk and keeping the safe guard equipments etc were assumed to have mitigated the risk. But now in the era of fast changing global economy, the management of various types of risks have gained utmost importance.

This part of the study explains the concepts, process, its advantages and steps for implementation of risk management. It also deals with the fraud and reputation risk management and how the negative reputation of an entity may have adverse impact on the operations and profitability.

Part III - Compliances

Compliance means the complete alliance of various parts of the business – whether commercial, financial, or regulatory. It necessitates following the rules, both external and internal. Compliance with law and regulation must be managed as an integral part of any corporate strategy. The board of directors and management
must recognize the scope and implications of laws and regulations that apply to the company. They must establish a compliance management system as a supporting system of risk management system as it reduces compliance risk to a great extent. Compliance with the requirements of law through a compliance management programme can produce positive results at several levels.

This part of study explains the adequacy and effectiveness of the compliance system, internal compliance reporting mechanism and ensuring the best practices available for the good governance principles for compliance issues. It further details about the concept of internal control, elements of internal control and its efficacy, concept of Reporting which includes the financial as well as non-financial reporting.

**Part IV - Ethics & Sustainability**

Business Ethics is the application of ethical principles and methods of analysis to business. In past few decades business ethics has been given due importance in business, commerce and industry. Promotion of culture of ethics is an imperative, and it is increasingly being realized that it is the bedrock of good governance which ultimately re-instills the confidence of the stakeholder in the company.

Sustainable development is a broad concept that balances the need for economic growth with environmental protection and social equity. Sustainability is based on a simple principle: Everything that we need for our survival and well-being depends, either directly or indirectly, on our natural environment. Sustainability creates and maintains the conditions under which humans and nature can exist in productive harmony that permits fulfilling the social, economic and other requirements of the present and future generations.

This part of the study elaborates the concept and advantages of business ethics and also explains about corporate sustainability, its reporting framework and various models and approaches used for measuring the business sustainability.
Objective

Part-I: To develop skills of high order so as to provide thorough knowledge and insight into the corporate governance framework, best governance practices.

Part–II: To develop skills of high order so as to provide thorough knowledge and insight into the spectrum of risks faced by businesses.

Part-III: To develop the ability to devise and implement adequate and effective systems to ensure compliance of all applicable laws.

Part-IV: To acquire knowledge of ethics in business and framework for corporate sustainability reporting.

Detailed Contents

Part I: Governance (50 Marks)


2. Legislative Framework of Corporate Governance in India: Listed Companies, Unlisted Companies, PSUs, Banks and Insurance Companies.


4. Board Processes through Secretarial Standards.

5. Board Committees: Composition & Terms of Reference, Roles and Responsibilities.

6. Corporate Policies & Disclosures: Various policies and disclosures to be made as per regulatory requirements / voluntarily made as part of good governance.

8. Performance Evaluation of Board and Management: Evaluation of the performance of the Board as a whole, individual directors (including independent directors and Chairperson), various Committees of the Board and of the management.

9. Role of promoter/controlling shareholder, redressal against Oppression and Mismanagement.

10. Monitoring of group entities and subsidiaries.

11. Accounting and Audit related issues.


15. Corporate Governance and other Stakeholders: Employees, Customers, Lenders, Vendors, Government and Regulators, Society, etc.


17. Corporate Governance Forums.

18. Parameters of Better Governed Companies: ICSI National Award for Excellence in Corporate Governance.

19. Dealing with Investor Associations, Proxy Services Firms and Institutional Investors.

20. Family Enterprise and Corporate Governance.

Case Laws, Case Studies & Practical Aspects.

Part II: Risk Management (20 Marks)


Case Studies & Practical Aspects.

Part III: Compliances (20 Marks)

22. Compliance Management: Essentials of successful compliance program, Significance of Compliance, devising proper systems to ensure compliance, ensuring adequacy and effectiveness of compliance system, internal compliance reporting mechanisms, use of technology for compliance management.


25. Website Management: Meeting through Video Conferencing.

Case Studies & Practical Aspects
Part IV: Ethics & Sustainability (10 Marks)


28. Models / Approaches to measure Business Sustainability: Altman Z-Score Model, Risk Adjusted Return on Capital, Economic Value Added (EVA), Market Value Added (MVA), Sustainable Value Added Approach.


Case Studies & Practical Aspects
Lesson 1: Conceptual Framework of Corporate Governance

Corporate Governance is how a corporation is administered or controlled. It is a set of processes, customs, policies, laws and instructions affecting the way a corporation is directed, administered or controlled. The participants in the process include employees, suppliers, partners, customers, government, and professional organization regulators, and the communities in which the organization has presence.

Corporate Governance is integral to the existence of the company. Corporate Governance is needed to create a corporate culture of transparency, accountability and disclosure.

Good corporate governance systems attract investment from global investors, which subsequently leads to greater efficiencies in the financial sector. The relation between corporate governance practices and the increasing international character of investment is very important. International flows of capital enable companies to access financing from a much larger pool of investors. In order to reap the full benefits of the global capital market and attract long-term capital, corporate governance arrangements must be credible, well understood across borders and should adhere to internationally accepted principles.

Corporate governance is a critical factor in economic stability and organisational success. In the last decade, many emerging markets, international bodies, governments, financial institutions, public and private sector bodies have reformed their corporate governance systems and are encouraging debate and spearheading initiatives towards good corporate governance. Better regulatory and self-regulatory corporate governance frameworks and enforcement mechanisms are being implemented through tougher legislations and Corporate Governance Codes.

The Companies Act, 2013 envisages radical changes in the sphere of Corporate Governance in India. It is set to provide a major overhaul in Corporate Governance norms and have far-reaching implications on the manner in which corporate operates in India.

This Lesson gives an overview of the evolution of Corporate Governance worldwide and the existence and development of corporate governance in India since centuries.

Lesson 2: Legislative Framework of Corporate Governance in India

Legislative aspects pertaining to various corporate governance requirements like Board Structure, Composition, Board Meetings, Powers of the Board, Committees, Independent Directors, Transparency and Disclosure highlighting the relevant provisions of Companies Act, and SEBI Listing Regulations, 2015 are discussed in this lesson.

This lesson discusses about various disclosure and transparency requirements under Companies Act 2013 and SEBI Regulations. A Company has to formulate specific policies in different areas of operations that help to bring uniformity in processes by clearly defining the business approach. Some of the policies are legally required, some are organisational needs and some are voluntarily made as part of good governance. This lesson also explains about the whistle blower mechanism and vigil mechanism. Various disclosures mandatorily required by the listed entities are also elaborated in detail in this chapter.
Lesson 3: Corporate Governance in Banks, Insurance and Public Sector Companies

The Companies Act, 2013 is applicable to all companies registered under the Act. However the same is not the case with nationalized banks as these are governed by separate Acts. The sector specific companies i.e. banking/insurance/public sector are required to follow the regulatory norms prescribed by their sectoral regulator.

For example, Insurance companies are subject to compliance with IRDA guidelines in addition to other applicable legislations. The guidelines issued by the IRDA on the Corporate Governance norms applicable to the Insurance Company have been dealt with in the chapter.

The lesson details the corporate governance developments in Banks and NBFCs. Also details the guidelines for the insurance companies. Stewardship Code for insurers in India has also been explained.

Lesson 4: Board Effectiveness-Issues and Challenges

Company being an artificial person it requires certain natural persons to represent the company at various fronts. The position of directors in their relationship to the company is not only as the agents, but also trustees of the company.

The Board of Directors plays a pivotal role in ensuring good governance. The contribution of directors on the Board is critical to the way a corporate conducts itself. A board’s responsibilities derive from law, custom, tradition and prevailing practices.

In the present times transparency, disclosure, accountability, issues of sustainability, corporate citizenship, globalization are some of the concerns that the Boards have to deal with. In addition, the Boards have to respond to the explosive demands of the marketplace. This two dimensional role of the Board of Directors is the cornerstone in evolving a sound, efficient, vibrant and dynamic corporate sector for attaining of high standards in integrity, transparency, conduct, accountability as well as social responsibility.

This lesson gives an insight on the role of directors, types of boards, diversity in Boardrooms, Governance functionaries, Chairman & Chief Executive Officer and Lead Independent Director.

Lesson 5: Board Committees

A board committee is a small working group identified by the board, consisting of board members, for the purpose of supporting the board’s work. Committees are generally formed to perform some expertise work and improve board effectiveness and efficiency.

Companies Act, 2013 requires certain class of companies to form some committees mandatorily. Similarly SEBI (LODR) Regulations, 2015 makes it mandatory for the listed companies to formulate certain committees of the board.

In this lesson role and functioning various committees like audit committee, stakeholder relationship committee, corporate social responsibility committee is explained.

For the prospective company secretaries this lesson shall be useful in performing the advisory role and in compliance management in practical areas of work.

Lesson 6: Corporate Governance and Shareholders Rights

The central element in corporate governance is the challenges arising out of separation of ownership and control. The shareholders are the true owners of a corporate and the governance function controls the operations of the corporate. There is a strong likelihood that there is a mismatch between the expectations of
the shareholders and the actions of the management. Therefore there is a need to lay down clearly the rights of the shareholders and that of the management.

SEBI Act, 1992, the various SEBI Regulations and Guidelines and the Companies Act, 2013 enables the empowerment of shareholder rights. Companies Act, 2013 provides for some measures to protect the interest of minority shareholders.

One of the objectives of the SEBI is to provide a degree of protection to the investors and to safeguard their rights, steady flow of savings into market and to promote the development of and regulate the securities market. Investors should be safeguarded not only against frauds and cheating but also against the losses arising out of unfair practices.

This lesson will enable the students to understand what the rights of the shareholders are and how it is important from corporate governance perspective.

**Lesson 7: Corporate Governance and Other Stakeholders**

In a business context, customers, investors, shareholders, employees, suppliers, government agencies, communities and many others who have a 'stake' or claim in some aspect of a company's products, operations, markets, industry and outcomes are known as stakeholders.

Stakeholders are characterized by their relationship to the company and their needs, interests and concerns, which will be foremost in their minds at the start of an engagement process. However, as the process unfolds they will soon take a particular role with related tasks and responsibilities.

A major reason for increasing adoption of a Stakeholder Concept in setting business objectives is the recognition that businesses are affected by the "environment" in which they operate. Businesses come into regular contact with customers, suppliers, government agencies, families of employees, special interest groups. Decisions made by a business are likely to affect one or more of these "stakeholder groups".

Stakeholders can only be well informed and knowledgeable if companies are transparent and report on issues that impact stakeholders. Both parties have an obligation to communicate sincerely and attempt to understand, not just be understood.

In this lesson relationship between company and various stakeholders has been discussed and explained how better stakeholder engagement ensures good governance.

**Lesson 8: Governance and Compliance Risk**

Historically, boards have been perceived to focus primarily on value creation for shareholders. But with renewed attention to statutory compliance, regulators now also want boards to focus on value management and value protection by doing a formal review of compliance obligations. As a result, corporations are looking to replace informal compliance frameworks with well structured, documented and demonstrable compliance structures that help management monitor and report compliance risk and exposure as well as compliance status to the Board.

Regulatory compliance is an organization's adherence to laws, regulations, guidelines and specifications relevant to its business. Violations of regulatory compliance regulations often result in legal punishment, including penalties/ fines. As the number of rules has increased since the turn of the century, regulatory compliance has become more prominent in a variety of organizations. The trend has even led to the creation of corporate, chief and regulatory compliance officer positions to hire employees whose sole focus is to make sure the organization conforms to stringent, complex legal mandates.
This lesson describes the importance compliance and consequences of non compliance. Besides, it also highlights the importance of corporate compliance management and compliance risks.

**Lesson 9: Corporate Governance Forums**

The world has become a borderless global village. The spirit to implement internationally accepted norms of corporate governance standards found expression in private sector, public sector and the government thinking. The framework for corporate governance is not only an important component affecting the long-term prosperity of companies, but it is critical in terms of National Governance, Human Governance, Societal Governance, Economic Governance and Political Governance since the activities of the corporate have an impact on every aspect of the society as such.

The need to find an institutional framework for corporate governance and to advocate its cause has resulted in the setting up and constitution of various corporate governance forums and institutions the world over. In this study lesson we will be discussing with some of the prominent Forums and Institutions of Corporate Governance.

**Lesson 10: Promoters and Minority Shareholders**

A promoter is a person, firm or company who does the preliminary work for the formation of a company, including framing its memorandum and articles of association, its incorporation process and initial raising of capital for business. A promoter is neither a trustee nor an agent of the company but he has a fiduciary relationship with the company. Fiduciary relation means a relation of trust and confidence.

When an individual, organization or group of shareholders together hold or control more than 50% shares of the company they are known as majority shareholders. This gives them absolute control over the operations of the company particularly selection of board by deciding who will be appointed as directors.

Minority Shareholders, even as minorities have all the rights of a shareholder. According to OECD principles (OECD, 2015) ‘the corporate governance framework should protect and facilitate the exercise of shareholders’ rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.”

Companies Act 2013 has put in place several safeguards to protect the interest of minority shareholders. It is important for small and minority shareholders to actually exercise their rights to protect their interests.

This lesson shall enable the students to understand the role of promoters, rights of minority shareholders and the measures to prevent oppression and mismanagement.

**Lesson 11: Risk Management**

Risk and reward go hand by hand. We have often heard the statement that without risk there is no gain. Risk is inherent in the business. Different types of risk exist in the business according to the nature of the business and they are to be controlled and managed.

Risk Management is a continuous process of identifying, evaluating and assessing the inherent and potential risk, adopting the methods for its systematic reduction in order to sustainable business development.

Companies Act, 2013 provides that a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company.
SEBI (LODR) Regulations, 2015 also provides that company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the company.

The company secretaries are governance professionals whose role is to enforce a compliance framework to safeguard the integrity of the organization and to promote high standards of ethical behavior. He has a significant role in assisting the board of the organization to achieve its vision and strategy. The activities of the governance professional encompass legal and regulatory duties and obligations and additional responsibilities assigned by the employer.

This lesson shall enable the students to understand risk management framework, the definition and types of risks; risk management process; advantages of risk management; steps in risk management; legal provisions on risk management; who is responsible for risk management etc.

Lesson 12: Compliance Management

A compliance management system is the method by which corporate manage the entire compliance process. It includes the compliance program, compliance audit, compliance report etc. and in other words it is called compliance solution. The compliance program consists of the policies and procedures which guide in adherence of laws and regulations. The compliance audit is independent testing of level of compliance with various laws and regulations applicable.

The objective of this lesson is to enable the students to understand the importance of compliance management in order to inculcate the compliance culture in the corporate.

Lesson 13: Internal Control

Internal control, as defined in accounting and auditing, is a process for assuring achievement of an organization's objectives in operational effectiveness and efficiency, reliable financial reporting, and compliance with laws, regulations and policies. It is a means by which an organization's resources are directed, monitored, and measured. It plays an important role in detecting and preventing fraud and protecting the organization's resources, both physical (e.g., machinery and property) and intangible (e.g., reputation or intellectual property such as trademarks).

This lesson details various elements of internal control, techniques of internal control system and gives an insight on efficacy and limitations of internal audit.

Lesson 14: Reporting

Reporting may mean to provide the information to the stakeholders as per the requirement of the law.

Reporting is not the new concept. The companies are reporting through their annual report which is a comprehensive report on a company's activities throughout the preceding year. Annual reports are intended to give shareholders and other interested people information about the company's activities and financial performance. They may be considered as grey literature. The annual reports contains the financial reporting as well as non-financial reporting too.

Corporate reporting is an essential means by which companies communicate with investors as part of their accountability and stewardship obligations. The current financial reporting model was developed in the 1930's for an industrial world. In general, the model provides a backwards-looking review of performance and does not provide enough relevant information for decision-making today.

The current reporting model is like “looking in the rear-view mirror,” when in fact the road ahead is very
turbulent and there are huge impacts on the company, both societal and environmental. This lesson explains the regulatory requirements relating to reporting and also discusses about the SEBI Regulations on LODR, PIT, SAST.

Lesson 15: Ethics and Business

Ethics is a “Science of morals.” Present day global crisis has raised questions about the legitimacy of capitalism.

Ethical failures certainly played a role. While it remains to be seen whether and how many people blatantly broke the law, there are abundant signs of various forms of potentially unethical behavior. These include greed, unreasonable amounts of leverage, subtle forms of corruption (such as ratings agencies that appear to have had a conflict of interest), complex financial instruments that no one really understood, and herd behavior where people just followed along and failed to exercise independent judgment. Business leaders must use their personal moral compasses to make ethical decisions. As for the business’s compass, it should be oriented toward satisfying customers above all stakeholders. That is the orientation that allows for the greatest competitive success and profitability.

The objective of the study lesson is to enable the students understand the following:

- Inner Conscience and its Linkage to Governance
- The concept of business ethics
- Advantages of Ethics

Lesson 16: Sustainability and Corporate Social Responsibility

Sustainability is an emerging mega trend and is a measure of good corporate governance. Over the years, environmental issues have steadily encroached on businesses’ capacity to create value for the customers, shareholders, and other stakeholders. Globalized workforces and supply chains have created environmental pressures and attendant business liabilities. The rise of new world powers has intensified competition for natural resources (especially oil) and added a geopolitical dimension to sustainability.

Corporate Social Responsibility (CSR) is a concept whereby companies not only consider their profitability and growth, but also the interests of society and the environment by taking responsibility for the impact of their activities on stakeholders, environment, consumers, employees, communities, and all other members of the public sphere. The basic premise is that when the corporations get bigger in size, apart from the economic responsibility of earning profits, there are many other responsibilities attached to them which are more of non-financial/social in nature. These are the expectations of the society from these corporate to give something in return to the society with whose explicit or implicit help these entities stand where they are.

The objective of this study lesson is to enable the students to understand the concept, applicability and reporting in respect to Corporate Social Responsibility and Sustainability.

Lesson 17: Measuring Business Sustainability

The lesson explains the various models and approaches used for measuring the business sustainability. It is also explained how these models work and the accuracy and effectiveness of these models or approaches. Information Technology can play an important role in sustainability management, and can be gainfully leveraged specifically in the evaluation of sustainability performance.

The lesson will guide the students to understand the models and approaches used for measuring the business sustainability.
Lesson 18: Anti-Corruption and Anti-Bribery Laws in India

Indian laws and regulations often provide for considerable discretion in the hands of government agencies and personnel, and this can make interacting with government a subjective and time-consuming exercise.

While Indian anti-corruption laws are fairly stringent, corruption is not uncommon in India, and until recently the enforcement of anti-corruption laws left much to be desired. This has led to unfortunate notion (particularly outside India) that corruption is an accepted practice in India – however, this notion is misplaced, and recent years have been marked with growing public dissatisfaction over corruption and its cost to the Indian economy. Over the past five to six years, there has been a strong public sentiment against corruption, and high-profile instances of corruption have become key political and election issues.

The objective of this study lesson is to enable the students to understand the legal framework in India which regard to the prevailing Anti-Corruption and Anti-Bribery Laws.

Most importantly, the past few years have seen a change in attitude of enforcement agencies, which have started enforcing anti-corruption laws aggressively in India, and have been supported in their efforts by the judiciary (which has taken up an active role in monitoring corruption cases) are discussed in this lesson.
2. Corporate Governance, Principles, policies and Practices – A.C. Fernando, Pearson Education
3. Corporate Governance – IICA, Taxmann
4. The Art of Corporate Governance – Dr. Joffy George
5. Journals - (a) ICSI – Chartered Secretary
   (b) ICSI – Student Company Secretary – E-bulletin
6. Companies Act 2013 and Rules
7. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
**ARRANGEMENT OF STUDY LESSONS**

**Module 1 – Paper 1**  
**Governance, Risk Management, Compliances and Ethics**

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## Lesson 1
### CONCEPTUAL FRAMEWORK OF CORPORATE GOVERNANCE

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## Lesson 2
### LEGISLATIVE FRAMEWORK OF CORPORATE GOVERNANCE IN INDIA

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Lesson 1
Conceptual Framework of Corporate Governance

LESSON OUTLINE
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• Definitions
• Need for Corporate Governance
• Elements of Good Corporate Governance
• Corporate Governance Theories
• Evolution of Corporate Governance
• Corporate Governance in Major Jurisdictions
  o South Africa
  o OECD Principles of Corporate Governance
  o Australia
  o Singapore
• Management vs. Ownership
• Majority vs. Minority
• Corporate Governance in Indian ethos
• Corporate Governance and Family Enterprises
• Glossary
• Lesson Round-Up
• Self Test Questions

LEARNING OBJECTIVES
The objective of this study lesson is to enable the students to understand the concept of Corporate Governance, to apprise about the developments across jurisdictions and to brief about the historic origin, need and importance of corporate governance.

This chapter also describes the importance and the elements of Good Corporate Governance. Besides, it also highlights the evolution of Corporate Governance in various countries of the world including India. It also discusses the corporate governance in Indian Ethos.

This chapter provides working knowledge for application of principles, theory and concepts of Corporate Governance. This chapter may also be useful in performing the advisory role in practical areas of work.

"Global market forces will sort out those companies that do not have sound corporate governance."

-Mervyn king S.C.
INTRODUCTION

GOVERNANCE

is concerned with the intrinsic nature, purpose, integrity and identity of an organization with primary focus on the entity’s relevance, continuity and fiduciary aspects.

The root of the word Governance is from ‘gubernate’, which means to steer. Corporate governance would mean to steer an organization in the desired direction. The responsibility to steer lies with the board of directors/governing board.

Corporate or a Corporation is derived from the Latin term “corpus” which means a “body”. Governance means administering the processes and systems placed for satisfying stakeholder expectation. When combined, Corporate Governance means a set of systems, procedures, policies, practices, standards put in place by a corporate to ensure that relationship with various stakeholders is maintained in transparent and honest manner.

Corporate Governance deals with determining ways to take effective strategic decisions. It gives ultimate authority and complete responsibility to the Board of Directors. Efficiency as well as globalization are significant factors urging corporate governance.

Corporate Governance is essential to develop added value to the stakeholders as it ensures transparency which ensures strong and balanced economic development. This also ensures that the interests of all shareholders (majority as well as minority shareholders) are safeguarded. It ensures that all shareholders fully exercise their rights and that the organization fully recognizes their rights.

Corporate Governance has a broad scope. It includes both social and institutional aspects. Corporate Governance encourages a trustworthy, moral, as well as ethical environment. In other words, the heart of corporate governance is transparency, disclosure, accountability and integrity. It is to be borne in mind that mere legislation does not ensure good governance. Good governance flows from ethical business practices even when there is no legislation.

DEFINITIONS OF CORPORATE GOVERNANCE

Noble Laureate Milton Friedman defined Corporate Governance as “the conduct of business in accordance with shareholders’ desires, which generally is to make as much money as possible, while conforming to the basic rules of the society embodied in law and local customs.”

Some other good definitions are given hereunder for better understanding:-

“Corporate Governance is concerned with the way corporate entities are governed, as distinct from the way business within those companies are managed. Corporate governance addresses the issues facing Board of Directors, such as the interaction with top management and relationships with the owners and others interested in the affairs of the company" - Robert Ian (Bob) Tricker (who introduced the words corporate governance for the first time in his book in 1984)

“Corporate Governance is about promoting corporate fairness, transparency and accountability”.

James D. Wolfensohn (Ninth President World Bank)
“Corporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.”

G20/OECD Principles of Corporate Governance

**Cadbury Committee, U.K**

“(It is) the system by which companies are directed and controlled”.

Corporate Governance is a system of structuring, operating and controlling a company with the following specific aims:—

(i) Fulfilling long-term strategic goals of owners;
(ii) Taking care of the interests of employees;
(iii) A consideration for the environment and local community;
(iv) Maintaining excellent relations with customers and suppliers;
(v) Proper compliance with all the applicable legal and regulatory requirements.

“Good corporate governance is about ‘intellectual honesty’ and not just sticking to rules and regulations, capital flowed towards companies that practiced this type of good governance.”

Mervyn King (Chairman: King Report)

“The exercise of ethical and effective leadership by the governing body towards the achievement of following governance outcomes:

- Ethical culture
- Good performance
- Effective control
- Legitimacy”

King Report on Corporate Governance for South Africa 2017

“Corporate governance deals with laws, procedures, practices and implicit rules that determine a company’s ability to take informed managerial decisions vis-à-vis its claimants - in particular, its shareholders, creditors, customers, the State and employees. There is a global consensus about the objective of ‘good’ corporate governance: maximising long-term shareholder value.”

“Corporate Governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company.”


“Corporate Governance is the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders.”

The Institute of Company Secretaries of India

Some of the salient advantages of Corporate Governance are stated hereunder:

1. Good corporate governance ensures corporate success and economic growth.
2. Strong corporate governance maintains investors’ confidence, as a result of which, company can raise capital efficiently and effectively.
3. There is a positive impact on the share price.
4. It provides proper inducement to the owners as well as managers to achieve objectives that are in interests of the shareholders and the organization.
5. Good corporate governance also minimizes wastages, corruption, risks and mismanagement.
6. It helps in brand formation and development.
7. It ensures organization in managed in a manner that fits the best interests of all.

**NEED FOR CORPORATE GOVERNANCE**

Corporate Governance is integral to the existence of the company. Corporate Governance is needed to create a corporate culture of transparency, accountability and disclosure.
(a) Corporate Performance

Improved governance structures and processes ensure quality decision-making, encourage effective succession planning for senior management and enhance the long-term prosperity of companies, independent of the type of company and its sources of finance. This can be linked with improved corporate performance—either in terms of share price or profitability.

(b) Enhanced Investor Trust

As individuals and institutions invest capital directly or through intermediary funds, they look to see if well-governed corporate boards are there to protect their interests. Investors who are provided with high levels of disclosure and transparency such as relating to data on matters such as pay governance, pay components, performance goals, and the rationale for pay decisions etc. are likely to invest openly in those companies. On Apple’s investor relations site, for example, the firm outlines its leadership and governance, including its executive team, its board of directors and also the firm’s committee charters and governance documents, such as bylaws, stock ownership guidelines etc.

The consulting firm McKinsey surveyed and determined that global institutional investors are prepared to pay a premium of up to 40 percent for shares in companies with superior corporate governance practices.

(c) Better Access to Global Market

Good corporate governance systems attract investment from global investors, which subsequently leads to greater efficiencies in the financial sector. The relation between corporate governance practices and the increasing international character of investment is very important. International flows of capital enable companies to access financing from a much larger pool of investors. In order to reap the full benefits of the global capital market and attract long-term capital, corporate governance arrangements must be credible, well understood across borders and should adhere to internationally accepted principles. On the other hand, even if corporations do not rely primarily on foreign sources of capital, adherence to good corporate governance practices helps improve the confidence of domestic investors, reduces the cost of capital, enables good functioning of financial markets and ultimately leads to more stable sources of finance.

(d) Combating Corruption

Companies that are transparent, and have sound system that provide full disclosure of accounting and auditing procedures, allow transparency in all business transactions, provide environment where corruption would certainly fade out. Corporate Governance enables a corporation to compete more efficiently and prevent fraud and malpractices within the organization.

(e) Easy Finance from Institutions

Several structural changes like increased role of financial intermediaries and institutional investors, size of the enterprises, investment choices available to investors, increased competition, and increased risk exposure have made monitoring the use of capital more complex thereby increasing the need of Good Corporate Governance. Evidences indicate that well-governed companies receive higher market valuations. The credit worthiness of a company can be trusted on the basis of corporate governance practiced in the company.

(f) Enhancing Enterprise Valuation
Improved management accountability and operational transparency fulfill investors’ expectations and confidence on management and corporations, and in return, increase the value of corporations.

(g) Reduced Risk of Corporate Crisis and Scandals

Effective Corporate Governance ensures efficient risk mitigation system in place. A transparent and accountable system makes the Board of a company aware of the majority of the mask risks involved in a particular strategy, thereby, placing various control systems in place to facilitate the monitoring of the related issues.

(h) Accountability

Investor relations are essential part of good corporate governance. Investors directly/indirectly entrust management of the company to create enhanced value for their investment. The company is hence obliged to make timely disclosures on regular basis to all its shareholders in order to maintain good investor relation. Good Corporate Governance practices create the environment whereby Boards cannot ignore their accountability to these stakeholders.

ELEMENTS OF GOOD CORPORATE GOVERNANCE

Some of the important elements of good corporate governance are discussed as under:
1. Role and powers of Board

Good governance is decisively the manifestation of personal beliefs and values which configure the organizational values, beliefs and actions of its Board. The board is the primary direct stakeholder influencing corporate governance.

Directors are elected by shareholders or appointed by other board members and are tasked with making important decisions, such as corporate officer appointments, executive compensation and dividend policy. In some instances, board obligations stretch beyond financial optimization, when shareholder resolutions call for certain social or environmental concerns to be prioritized.

The Board as a main functionary is primarily responsible to ensure value creation for its stakeholders. The absence of clearly designated role and powers of Board weakens accountability mechanism and threatens the achievement of organizational goals. Therefore, the foremost requirement of good governance is the clear identification of powers, roles, responsibilities and accountability of the Board, CEO, and the Chairman of the Board. The role of the Board should be clearly documented in a Board Charter.

2. Legislation

Clear and unambiguous legislation and regulations are fundamental to effective corporate governance. Legislation that requires continuing legal interpretation or is difficult to interpret on a day-to-day basis can be subject to deliberate manipulation or inadvertent misinterpretation.

3. Management environment

Management environment includes setting-up of clear objectives and appropriate ethical framework, establishing due processes, providing for transparency and clear enunciation of responsibility and accountability, implementing sound business planning, encouraging business risk assessment, having right people and right skill for the jobs, establishing clear boundaries for acceptable behaviour, establishing performance evaluation measures and evaluating performance and sufficiently recognizing individual and group contribution.

4. Board skills

To be able to undertake its functions efficiently and effectively, the Board must possess the necessary blend of qualities, skills, knowledge and experience. Each of the directors should make quality contribution. A Board should have a mix of the following skills, knowledge and experience:

→ Operational or technical expertise, commitment to establish leadership;
→ Financial skills;
→ Legal skills; and
→ Knowledge of Government and regulatory requirement.

5. Board appointments

To ensure that the most competent people are appointed on the Board, the Board positions should be filled through the process of extensive search. A well-defined and open procedure must be in place for reappointments as well as for appointment of new directors. Appointment mechanism should satisfy all statutory and administrative requirements. High on the priority should be an understanding of skill requirements of the Board particularly at the time of making a choice for appointing a new director. All new directors should be provided with a letter of appointment setting out in detail their duties and responsibilities.
The role of the board of directors was summarized by the King Report (a South African report on corporate governance) as:

- to define the purpose of the company
- to define the values by which the company will perform its daily duties
- to identify the stakeholders relevant to the company
- to develop a strategy combining these factors
- to ensure implementation of this strategy.

6. Board induction and training

Directors must have a broad understanding of the area of operation of the company’s business, corporate strategy and challenges being faced by the Board. Attendance at continuing education and professional development programmes is essential to ensure that directors remain abreast of all developments, which are or may impact on their corporate governance and other related duties.

7. Board independence

Independent Board is essential for sound corporate governance. This goal may be achieved by associating sufficient number of independent directors with the Board. Independence of directors would ensure that there are no actual or perceived conflicts of interest. It also ensures that the Board is effective in supervising and, where necessary, challenging the activities of management. The Board needs to be capable of assessing the performance of managers with an objective perspective. Accordingly, the majority of Board members should be independent of both the management team and any commercial dealings with the company.

8. Board meetings

Directors must devote sufficient time and give due attention to meet their obligations. Attending Board meetings regularly and preparing thoroughly before entering the Boardroom increases the quality of interaction at Board meetings. Board meetings are the forums for Board decision-making. These meetings enable directors to discharge their responsibilities. The effectiveness of Board meetings is dependent on carefully planned agendas and providing relevant papers and material to directors sufficiently prior to Board meetings.

9. Code of conduct

It is essential that the organization’s explicitly prescribed norms of ethical practices and code of conduct are communicated to all stakeholders and are clearly understood and followed by each member of the organization. Systems should be in place to periodically measure, evaluate and if possible recognise the adherence to code of conduct.

10. Strategy setting

The objectives of the company must be clearly documented in a long-term corporate strategy including an annual business plan together with achievable and measurable performance targets and milestones.

11. Business and community obligations

Though basic activity of a business entity is inherently commercial yet it must also take care of community’s obligations. Commercial objectives and community service obligations should be clearly documented after approval by the Board. The stakeholders must be informed about the proposed and ongoing initiatives taken to meet the community obligations.
12. Financial and operational reporting
The Board requires comprehensive, regular, reliable, timely, correct and relevant information in a form and of a quality that is appropriate to discharge its function of monitoring corporate performance. For this purpose, clearly defined performance measures - financial and non-financial should be prescribed which would add to the efficiency and effectiveness of the organisation.

The reports and information provided by the management must be comprehensive but not so extensive and detailed as to hamper comprehension of the key issues. The reports should be available to Board members well in advance to allow informed decision-making. Reporting should include status report about the state of implementation to facilitate the monitoring of the progress of all significant Board approved initiatives.

13. Monitoring the Board performance
The Board must monitor and evaluate its combined performance and also that of individual directors at periodic intervals, using key performance indicators besides peer review. The Board should establish an appropriate mechanism for reporting the results of Board’s performance evaluation results.

14. Audit Committees
The Audit Committee is inter alia responsible for liaison with the management; internal and statutory auditors, reviewing the adequacy of internal control and compliance with significant policies and procedures, reporting to the Board on the key issues. The quality of Audit Committee significantly contributes to the governance of the company.

15. Risk management
Risk is an important element of corporate functioning and governance. There should be a clearly established process of identifying, analyzing and treating risks, which could prevent the company from effectively achieving its objectives. It also involves establishing a link between risk-return and resourcing priorities. Appropriate control procedures in the form of a risk management plan must be put in place to manage risk throughout the organization. The plan should cover activities as diverse as review of operating performance, effective use of information technology, contracting out and outsourcing.

The Board has the ultimate responsibility for identifying major risks to the organization, setting acceptable levels of risk and ensuring that senior management takes steps to detect, monitor and control these risks.

It should be understood that effective risk management is not about eliminating risk taking, which is a fundamental driving force in business and entrepreneurship. The aim is to ensure that risks are understood, managed and, when appropriate, communicated. Effective implementation of risk management requires an enterprise-wide approach rather than treating each business unit individually. It should be considered good practice to involve the board in both establishing and overseeing the risk management structure.

The Board should also review and provide guidance about the alignment of corporate strategy with risk-appetite and the internal risk management structure. The process of risk management and the results of risk assessments should be appropriately disclosed. Without revealing any trade secrets, the board should make sure that the firm communicates to the market, material risk factors in a transparent and understandable fashion. Disclosure of risk factors should be focused on those identified as more relevant and/or should rank material risk factors in order of importance on the basis of a qualitative selection whose criteria should also be disclosed.

Thus, the Board must satisfy itself that appropriate risk management systems and procedure are in place to
identify and manage risks. For this purpose the company should subject itself to periodic external and internal risk reviews.

**CORPORATE GOVERNANCE THEORIES**

The following theories elucidate the basis of corporate governance:

(a) **Agency Theory**

According to this theory, managers act as 'Agents' of the corporation. The owners set the central objectives of the corporation. Managers are responsible for carrying out these objectives in day-to-day work of the company. Corporate Governance is control of management through designing the structures and processes.

In agency theory, the owners are the principals. But principals may not have knowledge or skill for getting the objectives executed. Thus, principal authorises the manangers to act as 'Agents' and a contract between principal and agent is made. Under the contract of agency, the agent should act in good faith. He should protect the interest of the principal and should remain faithful to the goals.

In modern corporations, the shareholdings are widely spread. The management (the agent) directly or indirectly selected by the shareholders (the Principals), pursue the objectives set out by the shareholders. The main thrust of the Agency Theory is that the actions of the management differ from those required by the shareholders to maximize their return.

The principals who are widely scattered may not be able to counter this in the absence of proper systems in place as regards timely disclosures, monitoring and oversight. Corporate Governance puts in place such systems of oversight.

(b) **Shareholder Theory**

According to this theory, it is the corporation which is considered as the property of shareholders/stockholders. They can dispose off this property, as they like. They want to get maximum return from this property.

The owners seek a return on their investment and that is why they invest in a corporation. But this narrow role has been expanded into overseeing the operations of the corporations and its manangers to ensure that the corporation is in compliance with ethical and legal standards set by the government. So the directors are responsible for any damage or harm done to their property i.e., the corporation. The role of managers is to maximise the wealth of the shareholders. They, therefore should exercise due diligence, care and avoid conflict of interest and should not violate the confidence reposed in them. The agents must be faithful to shareholders.

(c) **Stakeholder Theory**

According to this theory, the company is seen as an input-output model and all the interest groups which include creditors, employees, customers, suppliers, local-community and the government are to be considered. From their point of view, a corporation exists for them and not the shareholders alone.
The different stakeholders also have a self interest. The interests of these different stakeholders are at times conflicting. The managers and the corporation are responsible to mediate between these different stakeholders interest. The stakeholders have solidarity with each other. This theory assumes that stakeholders are capable and willing to negotiate and bargain with one another. This results in long term self interest.

The role of shareholders is reduced in the corporation. But they should also work to make their interest compatible with the other stakeholders. This requires integrity and managers play an important role here. They are faithful agents but of all stakeholders, not just stockholders.

(d) Stewardship Theory

The word 'steward' means a person who manages another's property or estate. Here, the word is used in the sense of guardian in relation to a corporation, this theory is value based. The managers and employees are to safeguard the resources of corporation and its property and interest when the owner is absent. They are like a caretaker. They have to take utmost care of the corporation. They should not use the property for their selfish ends. This theory thus makes use of the social approach to human nature.

The managers should manage the corporation as if it is their own corporation. They are not agents as such but occupy a position of stewards. The managers are motivated by the principal’s objective and the behavior pattern is collective, pro-organizational and trustworthy. Thus, under this theory, first of all values as standards are identified and formulated. Second step is to develop training programmes that help to achieve excellence. Thirdly, moral support is important to fill any gaps in values.

### EVOLUTION OF CORPORATE GOVERNANCE

#### Corporate Governance Developments in USA

<table>
<thead>
<tr>
<th>Years</th>
<th>Developments</th>
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<tbody>
<tr>
<td>1977</td>
<td>The Foreign Corrupt Practices Act provides for specific provisions regarding establishment, maintenance and review of systems of internal control.</td>
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<td>1985</td>
<td>Treadway commission emphasized the need of putting in place a proper control environment, desirability of constituting independent boards and its committees and objective internal audit function. As a consequence, the Committee of Sponsoring Organisations (COSO) took birth.</td>
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<td>1992</td>
<td>COSO issued Internal Control – Integrated Framework. The Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued Internal Control – Integrated Framework. It is a framework “to help businesses and other entities assess and enhance their internal control systems”.</td>
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<tr>
<td>2002</td>
<td>The Act made fundamental changes in virtually every aspect of corporate governance in general and auditor independence, conflict</td>
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Sarbanes – Oxley Act

of interests, corporate responsibility, enhanced financial disclosures and severe penalties for willful default by managers and auditors, in particular.

The Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010

Vote on Executive Pay and Golden Parachutes: Gives shareholders a say on pay with the right to a non-binding (advisory) vote on executive pay and golden parachutes (acquisitions). This gives shareholders a powerful opportunity to hold accountable executives of the companies they own, and a chance to disapprove where they see the kind of misguided incentive schemes that threatened individual companies and in turn the broader economy.

The Act has also suggested promulgation of concepts such as Chair/CEO split, clawback policy, disclosure of employee and director hedging, independence of compensation committee, proxy access and protection of whistleblowers etc.

<table>
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<tr>
<th>Corporate Governance Developments in UK</th>
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<td><strong>1992 Cadbury Report</strong></td>
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| The Committee on the Financial Aspects of Corporate Governance under the chairmanship of Sir Adrian Cadbury was set up in May 1991 by the Financial Reporting Council, the Stock Exchange and the accountancy profession in response to continuing concern about standards of financial reporting and accountability, particularly in light of the BCCI and Maxwell cases. The Committee submitted its report in 1992 and developed a set of principles of good corporate governance which were incorporated into the London Stock Exchange (LSE)’s Listing Rules. It also introduced the principle of ‘comply or explain’. It made the following three basic recommendations:  
the CEO and Chairman of companies should be separated; 
boards should have at least three non-executive directors, two of whom should have no financial or personal ties to executives; and 
each board should have an audit committee composed of non-executive directors. |
| **1995 Greenbury Report**              |
| The Confederation of British Industry constituted a group under the chairmanship of Sir Richard Greenbury to make recommendations on Directors’ Remuneration. The group submitted its report in 1995, its major findings were as under:  
Constitution of a Remuneration Committee comprising of Non Executive Directors  
Responsibility of this committee in determining the remuneration of CEO and executive directors  
Responsibility of the committee in determining the remuneration policy.  
Level of disclosure to shareholders regarding the remuneration of directors’.  
Remuneration should be linked more explicitly to performance. |
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<tr>
<th>Year</th>
<th>Event</th>
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<tr>
<td>1998</td>
<td>Hampel Report</td>
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<td>1998</td>
<td>Combined Code on Corporate Governance</td>
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<td>1999</td>
<td>Turnbull Report</td>
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<td>2001</td>
<td>Myners: Review of Institutional Investment</td>
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<tr>
<td>2003</td>
<td>Higgs Report</td>
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</table>

**Lesson 1 = Conceptual framework of Corporate Governance**

These findings were incorporated in Code of Best Practice on Directors’ Remuneration of the Report. The majority of the recommendations were incorporated in Listing Rules of London Stock Exchange.

The Hampel Committee was established in November, 1995 to review and revise the earlier recommendations of the Cadbury and Greenbury Committees. An important development was in the area of accountability and audit. The Board was identified as having responsibility to maintain a sound system of internal control, thereby safeguarding shareholders’ investments. Further, the Board was to be held accountable for all aspects of risk management. Recommendations of this Report and further consultations by the London Stock Exchange became the Combined Code on Corporate Governance.

The resulting Hampel Report led to the publication of Combined Code which applied to all listed companies. It added that:

- the Chairman of the board should be seen as the “leader” of the non-executive directors;
- institutional investors should be responsible to make considered use of their vote;
- all kinds of remuneration including pensions should be disclosed.

The Turnbull Committee was established to provide direction on the internal control requirements of the Combined Code, including how to carry out risk management. The report informs directors of their obligations under the Combined Code with regard to keeping good "internal controls" in their companies, or having good audits and checks to ensure the quality of financial reporting and catch any fraud before it becomes a problem. Turnbull Committee published “Internal Control Guidance for Directors on Combined Code”. Revised version was issued in 2004. Further Revised “Internal Control Guidance for Directors on Combined Code” were issued in October, 2005.

Paul Myners ‘Institutional Investment in the UK: A Review’ published in 2001, was commissioned by the Government, ‘to consider whether there were factors distorting the investment decision-making of institutions.’ The analysis contained in the Report pointed to a number of problems with the existing structures used by the various types of institutional investors to make investment decisions.

Sir Derek Higgs was commissioned by the UK Government to review the roles of independent directors and of audit committees. The resulting Report proposed that:

- at least half of a board (excluding the Chair) be comprised of non-executive directors;
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<th>Year</th>
<th>Event</th>
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<tr>
<td>2003</td>
<td>The Tyson Report on the recruitment and development of non-executive directors commissioned by the Department of Trade and Industry.</td>
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<td>2009</td>
<td>Walker Review of Corporate Governance of UK Banking Industry</td>
<td>The principal focus of this Review was on banks, but many of the issues arising, and associated, conclusions and recommendations, are relevant – if in a lesser degree – for other major financial institutions such as life assurance companies. The terms of reference were as follows: To examine corporate governance in the UK banking industry and make recommendations, including in the following areas: the effectiveness of risk management at board level, including the incentives in remuneration policy to manage risk effectively; the balance of skills, experience and independence required on the boards of UK banking institutions; the effectiveness of board practices and the performance of audit, risk, remuneration and nomination committees; the role of institutional shareholders in engaging effectively with companies and monitoring of boards; and whether the UK approach is consistent with international practice and how national and international best practice can be promulgated.</td>
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<td>2011</td>
<td>Sharman Inquiry</td>
<td>The Financial Reporting Council announced the launch of an enquiry led by Lord Sharman to identify lessons for companies and auditors addressing going concern and liquidity risk.</td>
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<tr>
<td>2010 - 2012</td>
<td>Stewardship Code</td>
<td>The UK Stewardship Code traces its origins to ‘The Responsibilities of Institutional Shareholders and Agents: Statement of Principles,’ first published in 2002 by the Institutional Shareholders Committee (ISC), and which converted to a code in 2009. The Stewardship Code aims to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities. Engagement includes pursuing purposeful dialogue on strategy, performance and the management of risk, as well as on issues that are the immediate subject of votes at general meetings. The Code is addressed in the first instance to firms who manage assets on behalf of institutional shareholders such as pension funds, insurance companies, investment trusts and other collective investment vehicles.</td>
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</table>
Lesson 1 = Conceptual framework of Corporate Governance

As per the principles, the institutional investors should: 1. publicly disclose their policy on how they will discharge their stewardship responsibilities. 2. have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed. 3. monitor their investee companies. 4. establish clear guidelines on when and how they will escalate their stewardship activities. 5. be willing to act collectively with other investors where appropriate. 6. have a clear policy on voting and disclosure of voting activity. 7. report periodically on their stewardship and voting activities.

2003 - 2016 Revision of Combined Code on Corporate Governance


The Code was further revised in 2006 after following two consultation exercises.

Changes reflecting new European Union (EU) requirements relating to Audit Committees and corporate governance statements catered through the revision in 2008. The revised Code sets out standards of good practice in relation to issues such as board composition and development, remuneration, accountability and audit and relations with shareholders. All companies incorporated in the UK and listed on the main market of the London Stock Exchange are required under the Listing Rules to report on how they have applied the Combined Code in their annual report and accounts.

In 2010, the Code was further revised for changes included a revised format to give clearer advice on board composition; that all FTSE 350 directors be put forward for re-election every year; and improved risk management reporting provisions.

The changes in the revised Code of 2012 included better reporting by Audit Committees; confirmation by Boards that the annual report and accounts taken as whole are fair, balanced and understandable; and that companies explain and report on progress with their policies on boardroom diversity.

The changes in 2014 to the Corporate Governance Code were designed to strengthen the focus of companies and investors on the longer term and the sustainability of value creation. In this update of the Code, the Financial Reporting Council (FRC) has focused on the provision by companies of information about the risks which affect longer term viability. In doing so the information needs of investors has been balanced against setting appropriate reporting requirements. Companies will now need to present information to give a clearer and broader view of solvency, liquidity, risk management and viability. For their part, investors will need to assess these statements thoroughly and engage accordingly. In addition, boards of listed companies will need to ensure that executive remuneration is aligned to the long-term success of the company and demonstrate this more clearly to shareholders.

The revised Code (2016) is also based on the Comply - or – explain approach and sets standards of good practice in relation to board leadership and
effectiveness, remuneration, accountability and relations with shareholders. The Code contains broad principles and more specific provisions. Listed companies are required to report on how they have applied the main principles of the Code, and either to confirm that they have complied with the Code's provisions or - where they have not - to provide an explanation. Some of the provisions of the Code require disclosures to be made in order to comply with them.

In November 2016 the Department for Business, Energy and Industrial Strategy (BEIS) published a Green Paper on corporate governance reform which focused on executive pay and strengthening the voice of employees and other stakeholders in the boardroom.

Consequently, Financial Reporting Council (FRC) made an announcement in February 2017 to take account of the issues raised in the BEIS Green Paper by undertaking a fundamental review of UK Code of Corporate Governance.

On 29 August 2017 the Government identified a number of proposals that it intended to take forward, including inviting the FRC to initiate a consultation with the aim of revising the UK Corporate Governance Code in a number of key areas. On 5 December 2017 the FRC published for consultation proposed revisions to the UK Corporate Governance Code and Guide on Board Effectiveness. The proposed revised UK Corporate Governance Code is fundamentally rewritten and is shorter and more concise than the existing version, comprising 17 Principles and 41 Provisions. The existing supporting Principles have been removed. In some cases they have been incorporated into the new Principles and Provisions or alternatively moved to the Guidance on Board Effectiveness. A summary of the proposed changes includes:

- insertion of a new Provision requiring the board to explain in the annual report how it has engaged with the company’s workforce and other stakeholders, and how their interests and the matters set out in section 172 of the Companies Act 2006 (the director’s duty to promote the success of the company) has influenced the board’s decision-making

- insertion of a new Provision under which the board must establish a method for gathering the views of the company’s workforce, such method would normally be a director appointed from the workforce, a formal workforce advisory panel or a designated non-executive director

- insertion of a new Provision providing that, where more than 20 per cent. of votes have been cast against a resolution, the company should explain the actions it intends to take to consult shareholders to understand the reasons behind the result. No later than six months after the vote, an update should be published. The final summary should be provided in the annual report, or in the explanatory notes to resolutions at the next meeting, on the impact the feedback has had on the decisions of the board

- Strengthening the provisions on non-executive independence. In particular, the chair must demonstrate independence and meet the stated independence criteria throughout their tenure (not only on appointment)

- removal of all exemptions from the requirements of the UK Corporate Governance Code for companies below the FTSE 350, including in relation to board composition, board evaluation, annual re-election, and audit and remuneration committee composition

- broadening the requirements relating to diversity to incorporate the findings of the Parker Review Committee

- insertion of a requirement that, before appointment as chair of the remuneration committee, the
appointee should have served on a remuneration committee for at least 12 months

- expansion of the remuneration committee’s remit to include responsibility for oversight of company remuneration and workforce policies and practices
- extension of the vesting and holding period for shares granted or other forms of long-term incentives, in normal periods, from at least three years to at least five years
- insertion of a new Provision under which remuneration schemes and policies should provide boards with discretion to override formulaic outcomes.

Corporate Governance Developments in India

The initiatives taken by Government of India in 1991, aimed at economic liberalization, privatization and globalisation of the domestic economy, led India to initiate reform process in order to suitably respond to the developments taking place world over. On account of the interest generated by Cadbury Committee Report, the Confederation of Indian Industry (CII), the Associated Chambers of Commerce and Industry (ASSOCHAM) and, the Securities and Exchange Board of India (SEBI) constituted Committees to recommend initiatives in Corporate Governance.

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<tr>
<td>1998</td>
<td>Desirable Corporate Governance: A Code</td>
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<td></td>
<td>CII took a special initiative on Corporate Governance, the first institution initiative in Indian Industry. The objective was to develop and promote a code for Corporate Governance to be adopted and followed by Indian companies, whether in the Private Sector, the Public Sector, Banks or Financial Institutions, all of which are corporate entities. The final draft of the said Code was widely circulated in 1997. In April 1998, the Code was released. It was called Desirable Corporate Governance: A Code.</td>
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<td>1999</td>
<td>Kumar Mangalam Birla Committee</td>
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<td>The Securities and Exchange Board of India (SEBI) had set up a Committee on May 7, 1999 under the Chairmanship of Kumar Mangalam Birla to promote and raise standards of corporate governance. The Report of the committee was the first formal and comprehensive attempt to evolve a Code of Corporate Governance, in the context of prevailing conditions of governance in Indian companies, as well as the state of capital markets at that time. The recommendations of the Report, led to inclusion of Clause 49 in the Listing Agreement in the year 2000.</td>
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<td>2000</td>
<td>Task Force on Corporate Excellence through Governance</td>
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<td>In May 2000, the Department of Company Affairs [now Ministry of Corporate Affairs (MCA)] formed a broad-based study group under the chairmanship of Dr. P.L. Sanjeev Reddy, Secretary, DCA. The group was given the ambitious task of examining ways to “operationalise the concept of corporate excellence on a sustained basis”, so as to “sharpen India’s global competitive edge and to further develop corporate culture in the country”. In November 2000, a Task Force on Corporate Excellence set up by the group produced a report containing a range of recommendations for raising governance standards among all companies in India. It also suggested the setting up of a Centre for Corporate Excellence.</td>
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<tr>
<td>2002</td>
<td>The Enron debacle of 2001 involving the hand-in-glove relationship between the</td>
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<td>Year</td>
<td>Committee/Task Force</td>
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<td>2002</td>
<td>Naresh Chandra Committee</td>
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<td>2002</td>
<td>N. R. Narayana Murthy Committee</td>
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<td>2004</td>
<td>Dr. J. J. Irani Committee on Company Law</td>
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<tr>
<td>2009</td>
<td>CII's Task Force on Corporate Governance</td>
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<td>2009</td>
<td>Corporate Governance Voluntary Guidelines</td>
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<td>Year</td>
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<tr>
<td>2010</td>
<td>NASSCOM Recommendations</td>
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<td>2012</td>
<td>Policy Document on Corporate Governance</td>
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<td>2013</td>
<td>Companies Act</td>
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Director and formulation of CSR policy to spend 2% of average Net Profits during the three immediately preceding financial years in pursuance of CSR policy;

13. Secretarial Audit for the bigger companies.

Further the Companies (Amendment) Act, 2017 consisting of 93 amendments to the 2013 Companies Act, has resulted in changes related to legal definitions (related party, subsidiary company, associate company, independent directors, etc.) corporate governance,(eg. Ratification of auditors appointment and role of audit committee) and management compliance. It impacts different aspects of business management in India, including key structuring, disclosure, and compliance requirements.

<table>
<thead>
<tr>
<th>Year</th>
<th>Event/Committee</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>SEBI (Listing Obligations and Disclosure Requirements) Regulations</td>
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<tr>
<td></td>
<td>The SEBI has notified SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 for the listed entity who has listed designated securities on recognized stock exchanges. The provisions of Corporate Governance in SEBI (LODR) Regulations 2015 are discussed at relevant places in this study material.</td>
</tr>
<tr>
<td>2017</td>
<td>Uday Kotak Committee</td>
</tr>
<tr>
<td></td>
<td>The SEBI Committee on corporate governance was formed in June 2017 under the Chairmanship of Mr.Uday Kotak with the aim of improving standards of corporate governance of listed companies in India.</td>
</tr>
</tbody>
</table>

With the aim of improving standards of Corporate Governance of listed companies in India, the Committee was requested to make recommendations to SEBI on the following issues:

- Ensuring independence in spirit of Independent Directors and their active participation in functioning of the company;
- Improving safeguards and disclosures pertaining to Related Party Transactions;
- Issues in accounting and auditing practices by listed companies;
- Improving effectiveness of Board Evaluation practices;
- Addressing issues faced by investors on voting and participation in general meetings;
- Disclosure and transparency related issues, if any;
- Any other matter, as the Committee deems fit pertaining to corporate governance in India.

The Committee submitted its report to SEBI in October 2017. The recommendations of the Committee were given in 11 Chapters as follows:

- Composition and Role of the Board of Directors
- The Institution of Independent Directors
- Board Committees
Lesson 1 = Conceptual framework of Corporate Governance 21

- Enhanced Monitoring of Group Companies
- Promoters/Controlling Shareholders and Related Party Transactions
- Disclosures and Transparency
- Accounting and Audited related Issues
- Investors participation in Meetings of Listed Entities
- Governance aspects of Public Sector Enterprises
- Leniency Mechanism
- Capacity building in SEBI for enhancing Corporate Governance in Listed Entities

In its board meeting on March 27, 2018, SEBI, after detailed consideration and due deliberation, accepted several recommendations of the Kotak Committee without any modifications and accepted a few other recommendations with certain modifications as to timelines for implementation, applicability thresholds among others. Some of the major changes accepted relate to:

- Increasing Transparency -Enhanced Disclosure Requirements
- Disclosure of Utilization of Funds from Qualified Institutional Placement (QIP)/Preferential Issues
- Disclosures of Auditor Credentials, Audit Fee, Reasons for Resignation of Auditors
- Disclosure of Expertise/Skills of Directors
- Enhanced Disclosure of Related Party Transactions (RPT)-A
- Mandatory Disclosure of Consolidated Quarterly Results with effect from Financial Year 2019-2020-
- Reshaping the Institution of the Board of Directors and Enhancing the Role of Committees of the Board
- Separation of the office of the chairperson (i.e. the leader of the board) and CEO/MD (i.e. the leader of the management)
- Augmenting board strength and diversity
- Enhanced Quorum
- Capping the Maximum Number of Directorships
- Expanded Eligibility Criteria for Independent Directors
- Enhanced Role of committees
- Down-streaming Corporate Governance
- Enhanced Obligations on Listed Entities with Respect to Subsidiaries
- Secretarial Audit to be Mandatory for Listed Entities and their Material Unlisted Subsidiaries
Corporate governance is a critical factor in economic stability and organisational success. In the last decade, many emerging markets, international bodies, governments, financial institutions, public and private sector bodies have reformed their corporate governance systems and are encouraging debate and spearheading initiatives towards good corporate governance. Better regulatory and self-regulatory corporate governance frameworks and enforcement mechanisms are being implemented through tougher legislations and Corporate Governance Codes.

The legislative framework of corporate governance adopted by some of the countries like USA, Australia, Singapore, South Africa and United Kingdom are discussed below.

CORPORATE GOVERNANCE IN SOUTH AFRICA

In 1992, former South African Supreme Court Judge, Mervyn King was asked to chair a private sector body to draft corporate governance guidelines. The body became known as the King Committee, and its first report, issued in 1994, was regarded by many as ahead of its time in adopting an integrated and inclusive approach to the business life of companies, embracing stakeholders other than shareholders. Four reports were issued in 1994 (King I), 2002 (King II), 2009 (King III) and 2016 (King IV).

As the governance of corporations can be on a statutory basis, or as a code of principles and practices, or a combination of the two, South Africa opted for a code of principles and practices on a ‘comply or explain’ basis, in addition to certain governance issues that are legislated.

Following King II, the Johannesburg Stock Exchange Limited (JSE) required listed companies to include in their annual report a narrative statement as to how they had complied with the principles set out in King II, providing explanations that would enable stakeholders to evaluate the extent of the company’s compliance and stating whether the reasons for non-compliance were justified.

The release of King III report on 1 September 2009 marked a significant milestone in the evolution of corporate governance in South Africa and brought significant opportunities for organisations that embrace its principles. The King III was on an ‘apply or explain’ basis. The ‘apply or explain’ approach required more consideration – application of the mind and explanation of what has actually been done to implement the principles and best practice recommendations of governance.

The fundamental changes in both business and society of 21 Century provided the context within which the King Committee set out to draft King IV, and have influenced both its content and approach. King IV has moved from “apply or explain” to “apply and explain”. This outcomes-based approach for a Corporate Governance Code and the “apply and explain” regime are the original intellectual thinking of the King Committee.

A summarized position of the Reports are given hereunder for a better understanding:

<table>
<thead>
<tr>
<th>King I Report on Corporate Governance (1994)</th>
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<tbody>
<tr>
<td>In 1992, the King Committee on Corporate Governance was formed in South Africa, and, in line with international thinking, considered corporate governance from a South African perspective.</td>
</tr>
<tr>
<td>The result was the King Report 1994, which marked the institutionalization of corporate governance in South Africa. It aimed to promote corporate governance in South Africa and established recommended standards of conduct for boards and directors of listed companies, banks, and certain state-owned enterprises, with an emphasis on the need for companies to become a responsible part of the</td>
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</table>
societies in which they operate. King I advocated an integrated approach to good governance, taking into account stakeholder interests and encouraging the practice of good financial, social, ethical and environmental practice.

| **King II Report on Corporate Governance (2002)** | In 2002, the second King Report on Corporate Governance was published. It contains a Code of Corporate Practices and Conduct. It referred to seven characteristics of good corporate governance:

1. Discipline - a commitment to behaviour that is universally recognised and accepted as correct and proper.

2. Transparency - the ease with which an outsider is able to analyse a company's actions.

3. Independence – the extent to which mechanisms to avoid or minimize conflict have been put in place.

4. Accountability - the existence of mechanisms to ensure accountability so as to give investors, the means to query and assess the actions of the board and its committees.

5. Responsibility - processes that allow for penalizing mismanagement, taking corrective action and responsible action of management towards all stakeholders.

6. Fairness - balancing competing interests.

7. Social Responsibility - being aware of and responding to social issues placing high responsibility on ethical standards. |

| **King III Report on Corporate Governance (2009)** | King III became necessary because of the anticipated new Companies Act, 2008 and changing trends in international governance. As with King I and King II, the King Committee endeavoured to be at the forefront of governance internationally and focused on the importance of reporting annually on how a company has both positively and negatively affected the economic life of the community in which it operated during the year under review. In addition, emphasis has been placed on the requirement to report on how the company intends to enhance those positive aspects and eradicate or ameliorate any possible negative impacts on the economic life of the community in which it will operate in the year ahead.

1. King III is divided into nine chapters:

2. Ethical leadership and corporate citizenship

3. Boards and directors

4. Audit committees

5. The governance of risk

6. The governance of information technology |
- Compliance with laws, rules, codes and standards
- Internal audit
- Governing stakeholder relationships
- Integrated reporting and disclosure
- King III applies to “all entities regardless of the manner and form of incorporation or establishment and whether in the public, private or non-profit sectors.”

**King IV Report on Corporate Governance (2016)**

King IV has moved from “apply or explain” to “apply and explain”, but has reduced the 75 principles in King III to 17 basic principles in King IV, one of which applies to institutional investors only.

King IV has been structured as a Report that includes a Code, with additional, separate sector supplements for SME’s, NPO’s, State-Owned Entities, Municipalities and Retirement Funds. The King Code contains both principles and recommended practices aimed at achieving governance outcomes. 16 of these principles can be applied by any organisation, and all are required to substantiate a claim that good governance is being practiced. The required explanation allows stakeholders to make an informed decision as to whether or not the organisation is achieving the four good outcomes required by King IV.

Explanation also helps to encourage organisations to see corporate governance not as an act of mindless compliance, but something that will yield results only if it is approached mindfully, with due consideration of the organisation’s circumstances.

**CODE OF CORPORATE GOVERNANCE – KING IV REPORT**

King I, II and III had as their foundation ethical and effective leadership. King IV is no different. Clearly, good leadership, which is underpinned by the principles of good governance, is equally valuable in all types of organisations, not just those in the private sector. Similarly, the principles of good governance are equally applicable, and equally essential, in both public and private entities.

This link is implicit in King I, II and III; King IV seeks to make it explicit. Specifically, the King Committee was requested by many entities outside the private sector to draft King IV in such a way as to make it more easily applicable to all organisations: public and private, large and small, for-profit and not-for-profit.

King IV has been drafted with this in mind. Thus, for example, it talks of organisations and governing bodies, rather than simply companies and boards of directors. Another innovation aimed at making it easier for all organisations to use the King IV Report as a guide for good governance is the inclusion of sector supplements.

<table>
<thead>
<tr>
<th>Governance element</th>
<th>Principles</th>
</tr>
</thead>
</table>
| LEADERSHIP, ETHICS AND CORPORATE CITIZENSHIP | 1. The governing body should lead ethically and effectively.  
2. The governing body should govern the ethics of the organisation in a way that supports the establishment of an ethical culture. |
### Lesson 1  
Conceptual framework of Corporate Governance

<table>
<thead>
<tr>
<th>STRATEGY, PERFORMANCE AND REPORTING</th>
<th>3. The governing body should ensure that the organisation is and is seen to be a responsible corporate citizen.</th>
</tr>
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<tbody>
<tr>
<td>4. The governing body should appreciate that the organisation’s score purpose, its risks and opportunities, strategy, business model, performance and sustainable development are all inseparable elements of the value creation process.</td>
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<td>5. The governing body should ensure that reports issued by the organisation enable stakeholders to make informed assessments of the organisation’s performance, and its short, medium and long-term prospects.</td>
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</table>

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<tr>
<th>GOVERNING STRUCTURES AND DELEGATION</th>
<th>6. The governing body should serve as the focal point and custodian of corporate governance in the organisation.</th>
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<tbody>
<tr>
<td>7. The governing body should comprise the appropriate balance of knowledge, skills, experience, diversity and independence for it to discharge its governance role and responsibilities objectively and effectively.</td>
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<td>8. The governing body should ensure that its arrangements for delegation within its own structures promote independent judgement, and assist with balance of power and the effective discharge of its duties.</td>
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<tr>
<td>9. The governing body should ensure that the evaluation of its own performance and that of its committees, its chair and its individual members, support continued improvement in its performance and effectiveness.</td>
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<tr>
<td>10. The governing body should ensure that the appointment of, and delegation to, management contribute to role clarity and the effective exercise of authority and responsibilities.</td>
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<tr>
<th>GOVERNANCE FUNCTIONAL AREAS</th>
<th>11. The governing body should govern risk in a way that supports the organisation in setting and achieving its strategic objectives.</th>
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</thead>
<tbody>
<tr>
<td>12. The governing body should govern technology and information in a way that supports the organisation setting and achieving its strategic objectives.</td>
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<tr>
<td>13. The governing body should govern compliance with applicable laws and adopted, non-binding rules, codes and standards in a way that supports the organisation being ethical and a good corporate citizen.</td>
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<tr>
<td>14. The governing body should ensure that the organisation remunerates fairly, responsibly and transparently so as to promote the achievement of strategic objectives and positive outcomes in the short, medium and long term.</td>
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15. The governing body should ensure that assurance services and functions enable an effective control environment, and that these support the integrity of information for internal decision-making and of the organisation’s external reports.

### STAKEHOLDER RELATIONSHIPS

16. In the execution of its governance role and responsibilities, the governing body should adopt a stakeholder-inclusive approach that balances the needs, interests and expectations of material stakeholders in the best interests of the organisation over time.

17. The governing body of an institutional investor organisation should ensure that responsible investment is practiced by the organisation to promote the good governance and the creation of value by the companies in which it invests.

## OECD PRINCIPLES OF CORPORATE GOVERNANCE

Organisation for Economic Co-operation and Development (OECD) Principles of Corporate Governance were first released in May 1999 and were further revised in 2004. Following the request by the G20 Finance Ministers and Central Bank Governors at their meeting on 9-10 February 2015 in Istanbul, a draft of the revised Principles was presented and discussed at the G20/OECD Corporate Governance Forum in Istanbul on 10 April 2015 where they found broad support among participants. The Principles were subsequently presented at the May and August 2015 meetings of the G20 Investment and Infrastructure Working Group. The OECD Council adopted the Principles on 8 July 2015. The Principles are now submitted to the G20 Finance Ministers and Central Bank Governors meeting in Ankara 4-5 September for endorsement as joint G20/OECD Principles and transmission to the G20 Leaders Summit in November 2015.

The updated G20/OECD Principles of Corporate Governance (the Principles) therefore provide a very timely and tangible contribution to the G20 priority in 2015 to support investment as a powerful driver of growth.

The Principles are also about inclusiveness. Today, millions of households around the world have their savings in the stock market, directly or indirectly. And publicly listed companies provide for more than 200 million jobs. The Principles also address the rights of these stakeholders and their ability to participate in corporate wealth creation.

The OECD Principles of Corporate Governance are:

**I. Ensuring the basis for an effective corporate governance framework:**

The corporate governance framework should promote transparent and fair markets, and the efficient allocation of resources. It should be consistent with the rule of law and support effective supervision and enforcement.

**II. The rights and equitable treatment of shareholders and key ownership functions:**

The corporate governance framework should protect and facilitate the exercise of shareholders’ rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

**III. Institutional investors, stock markets, and other intermediaries:**

The corporate governance framework should provide sound incentives throughout the investment
chain and provide for stock markets to function in a way that contributes to good corporate governance

IV. The role of stakeholders in corporate governance:

The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises

V. Disclosure and transparency:

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company

VI. The responsibilities of the board:

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders

For detailed OECD Principles students may refer Chapter 6 on Corporate Governance and Shareholders Rights

CORPORATE GOVERNANCE IN AUSTRALIA

In order to ascertain that Australian companies are equipped to compete globally and to maintain and promote investor confidence both in Australia and overseas, ASX convened the ASX Corporate Governance Council in August 2002. Its purpose was to develop recommendations which reflect international good corporate governance practices.

The Council introduced the ASX Corporate Governance Council Principles and Recommendations (“Principles and Recommendations”) in 2003. A substantially re-written second edition was released in 2007 and new recommendations on diversity and the composition of the remuneration committee were added in 2010.

Since the release of the second edition in 2007, there has been considerable focus across the world on corporate governance practices in response to the Global Financial Crisis. A number of countries have adopted new legislations regulating corporate behaviour and upgraded their corporate governance codes. The ASX Corporate Governance Council also comprehensively reviewed its principles and issued the third edition of the Principles and Recommendations on 27th March 2014 reflecting global developments in corporate governance and simplifying the structure of the Principles and Recommendations. The revised principles also provide greater flexibility to listed entities in terms of where they make their governance disclosures.

Principles and Recommendations are non mandatory: These Principles and Recommendations recommend corporate governance practices for entities listed on the ASX that are likely to achieve good governance outcomes and meet the reasonable expectations of most investors in most situations. The Principles and Recommendations are not mandatory and do not seek to prescribe the corporate governance practices that a listed entity must adopt.
Principles and Recommendations are based on “if not, why not” approach: The “if not, why not” approach is fundamental to the operation of the Principles and Recommendations. Under the Principles and

Recommendations, if the board of a listed entity considers that a recommendation is not appropriate to its particular circumstances, it is entitled not to adopt it. However, it must explain why it has not adopted the recommendation – the “if not, why not” approach.

Applicability of the Principles and Recommendations: The Principles and Recommendations apply to all ASX listed entities, established in Australia or elsewhere and whether internally or externally managed. However, other bodies may formulate their governance rules or practices according to these principles as they reflect a contemporary view of appropriate corporate governance standards.

Disclosing compliance with the Principles and Recommendations under ASX’s Listing Rules:

The ASX listed entity is required under Listing Rule to include in its annual report a corporate governance statement. The corporate governance statement must disclose the extent to which the entity has followed the recommendations set by the ASX Council during the reporting period. If the entity has not followed a recommendation for any part of the reporting period, its corporate governance statement must (a) separately identify that recommendation and (b) the period during which it was not followed and (c) state its reasons for not following the recommendation and what (if any) alternative governance practices it adopted in lieu of the recommendation during that period.

By requiring listed entities to compare their corporate governance practices with the Council’s recommendations and, where they do not conform, to disclose that fact and the reasons why, Listing Rule acts to encourage listed entities to adopt the governance practices suggested in the Council’s recommendations.

Where to make disclosures as required by the Principles: A listed entity should disclose information as required by the principles in its annual report or on its website in a clearly delineated “corporate governance” section of the annual report.

Structure of the Principles and Recommendations: The Principles and Recommendations are structured around, and seek to promote following 8 central principles:

1. Lay solid foundations for management and oversight
2. Structure the board to add value
3. Act ethically and responsibly
4. Safeguard integrity in corporate reporting
5. Make timely and balanced disclosure
6. Respect the rights of security holders
7. Recognise and manage risk
8. Remunerate fairly and responsibly

There are 29 specific recommendations under these general principles.

Principle 1: Lay solid foundations for management and oversight

A listed entity should establish and disclose the respective roles and responsibilities of its board and management and how their performance is monitored and evaluated.
### Recommendations

| Recommendation 1.1 | A listed entity should disclose:  
|                    | (a) the respective roles and responsibilities of its board and management; and  
|                    | (b) those matters expressly reserved to the board and those delegated to management. |
| Recommendation 1.2 | A listed entity should:  
|                    | (a) undertake appropriate checks before appointing a person, or putting forward to security holders a candidate for election, as a director; and  
|                    | (b) provide security holders with all material information in its possession relevant to a decision on whether or not to elect or re-elect a director. |
| Recommendation 1.3 | A listed entity should have a written agreement with each director and senior executive setting out the terms of their appointment. |
| Recommendation 1.4 | The company secretary of a listed entity should be accountable directly to the board, through the chair, on all matters to do with the proper functioning of the board. |
| Recommendation 1.5 | A listed entity should:  
|                    | (a) have a diversity policy which includes requirements for the board or a relevant committee of the board to set measurable objectives for achieving gender diversity and to assess annually both the objectives and the entity’s progress in achieving them;  
|                    | (b) disclose that policy or a summary of it; and  
|                    | (c) disclose as at the end of each reporting period the measurable objectives for achieving gender diversity set by the board or a relevant committee of the board in accordance with the entity’s diversity policy and its progress towards achieving them, and either:  
|                    | the respective proportions of men and women on the board, in senior executive positions and across the whole organisation (including how the entity has defined “senior executive” for these purposes); or  
|                    | if the entity is a “relevant employer” under the Workplace Gender Equality Act, the entity’s most recent “Gender Equality Indicators”, as defined in and published under that Act. A relevant employer is a non-public sector employer with 100 or more employees in Australia for any 6 months or more of a reporting period. |
| Recommendation 1.6 | A listed entity should:  
|                    | (a) have and disclose a process for periodically evaluating the performance of the board, its committees and individual directors; and  
|                    | (b) disclose, in relation to each reporting period, whether a performance |
**Recommendation 1.7**

A listed entity should:

(a) have and disclose a process for periodically evaluating the performance of its senior executives; and

(b) disclose, in relation to each reporting period, whether a performance evaluation was undertaken in the reporting period in accordance with that process.

### Principle 2: Structure the board to add value

A listed entity should have a board of an appropriate size, composition, skills and commitment to enable it to discharge its duties effectively.

*A relevant employer is a non-public sector employer with 100 or more employees in Australia for any 6 months or more of a reporting period.

**Recommendations**

| Recommendation 2.1 | The board of a listed entity should:
|---------------------|---------------------------------------------------------------------------------|
|                     | (a) have a nomination committee which:
|                     |   o has at least three members, a majority of whom are independent directors; and
|                     |   o is chaired by an independent director,
|                     |   o and disclose:
|                     |     the charter of the committee;
|                     |     the members of the committee; and
|                     |     as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or
|                     | (b) if it does not have a nomination committee, disclose that fact and the processes it employs to address board succession issues and to ensure that the board has the appropriate balance of skills, knowledge, experience, independence and diversity to enable it to discharge its duties and responsibilities effectively.

| Recommendation 2.2 | A listed entity should have and disclose a board skills matrix setting out the mix of skills and diversity that the board currently has or is looking to achieve in its membership.

| Recommendation 2.3 | A listed entity should disclose:
|---------------------|------------------------------------------------------------------------------------------------------------------|
|                     | (a) the names of the directors considered by the board to be independent directors;
|                     | (b) if a director has an interest, position, association or relationship of the type described in below but the board is of the opinion that it does not compromise the independence of the director, the nature of the interest, position, association or relationship in question and an explanation of why
the board is of that opinion; and
(c) the length of service of each director.

Recommendation 2.4 A majority of the board of a listed entity should be independent directors.

Recommendation 2.5 The chair of the board of a listed entity should be an independent director and, in particular, should not be the same person as the CEO of the entity.

Recommendation 2.6 A listed entity should have a program for inducting new directors and provide appropriate professional development opportunities for directors to develop and maintain the skills and knowledge needed to perform their role as directors effectively.

Factors relevant to assessing the independence of a director [for Recommendation 2.3(b)]

Examples of interests, positions, associations and relationships that might cause doubts about the independence of a director include if the director:

- is, or has been, employed in an executive capacity by the entity or any of its child entities and there has not been a period of at least three years between ceasing such employment and serving on the board;
- is, or has within the last three years been, a partner, director or senior employee of a provider of material professional services to the entity or any of its child entities;
- is, or has been within the last three years, in a material business relationship (eg as a supplier or customer) with the entity or any of its child entities, or an officer of, or otherwise associated with, someone with such a relationship;
- is a substantial security holder of the entity or an officer of, or otherwise associated with, a substantial security holder of the entity;
- has a material contractual relationship with the entity or its child entities other than as a director;
- has close family ties with any person who falls within any of the categories described above; or
- has been a director of the entity for such a period that his or her independence may have been compromised.

In each case, the materiality of the interest, position, association or relationship needs to be assessed to determine whether it might interfere, or might reasonably be seen to interfere, with the director’s capacity to bring an independent judgement to bear on issues before the board and to act in the best interests of the entity and its security holders generally.

Principle 3: Act ethically and responsibly

A listed entity should act ethically and responsibly.

Recommendations

Recommendation 3.1 A listed entity should:
(a) have a code of conduct for its directors, senior executives and employees; and
(b) disclose that code or a summary of it.

Principle 4: Safeguard integrity in corporate reporting

A listed entity should have formal and rigorous processes that independently verify and safeguard the integrity of its corporate reporting.
## Recommendations

| Recommendation 4.1 | The board of a listed entity should:  
|---|---|
| (a) | have an audit committee which:  
| | o has at least three members, all of whom are non-executive directors and a majority of whom are independent directors; and  
| | o is chaired by an independent director, who is not the chair of the board,  
| and disclose:  
| | o the charter of the committee;  
| | o the relevant qualifications and experience of the members of the committee; and  
| | o in relation to each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or  
| (b) | If it does not have an audit committee, disclose that fact and the processes it employs that independently verify and safeguard the integrity of its corporate reporting, including the processes for the appointment and removal of the external auditor and the rotation of the audit engagement partner. |

| Recommendation 4.2 | The board of a listed entity should, before it approves the entity’s financial statements for a financial period, receive from its CEO and CFO a declaration that, in their opinion, the financial records of the entity have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the entity and that the opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively. |

| Recommendation 4.3 | A listed entity that has an AGM should ensure that its external auditor attends its AGM and is available to answer questions from security holders relevant to the audit. |

## Principle 5: Make timely and balanced disclosure

A listed entity should make timely and balanced disclosure of all matters concerning it that a reasonable person would expect to have a material effect on the price or value of its securities.

### Recommendations

| Recommendation 5.1 | A listed entity should:  
|---|---|
| (a) | have a written policy for complying with its continuous disclosure obligations under the Listing Rules; and  
| (b) | disclose that policy or a summary of it. |

## Principle 6: Respect the rights of security holders

A listed entity should respect the rights of its security holders by providing them with appropriate information
and facilities to allow them to exercise those rights effectively.

**Recommendations**

<table>
<thead>
<tr>
<th>Recommendation 6.1</th>
<th>A listed entity should provide information about itself and its governance to investors via its website.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recommendation 6.2</td>
<td>A listed entity should design and implement an investor relations program to facilitate effective two-way communication with investors.</td>
</tr>
<tr>
<td>Recommendation 6.3</td>
<td>A listed entity should disclose the policies and processes it has in place to facilitate and encourage participation at meetings of security holders.</td>
</tr>
<tr>
<td>Recommendation 6.4</td>
<td>A listed entity should give security holders the option to receive communications from, and send communications to, the entity and its security registry electronically.</td>
</tr>
</tbody>
</table>

**Principle 7: Recognise and manage risk**

A listed entity should establish a sound risk management framework and periodically review the effectiveness of that framework.

**Recommendations**

| Recommendation 7.1 | The board of a listed entity should:  
|--------------------|-------------------------------------------------------------------------------------------------------|
|                    | (a) have a committee or committees to oversee risk, each of which:  
|                    | o has at least three members, a majority of whom are independent directors; and  
|                    | o is chaired by an independent director, and disclose:  
|                    | o the charter of the committee;  
|                    | o the members of the committee; and  
|                    | o as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or  
|                    | (b) if it does not have a risk committee or committees that satisfy (a) above, disclose that fact and the processes it employs for overseeing the entity’s risk management framework. |
| Recommendation 7.2 | The board or a committee of the board should:  
|--------------------|-------------------------------------------------------------------------------------------------------|
|                    | (a) review the entity’s risk management framework at least annually to satisfy itself that it continues to be sound; and  
|                    | (b) disclose, in relation to each reporting period, whether such a review has taken place. |
| Recommendation 7.3 | A listed entity should disclose:  
|--------------------|-------------------------------------------------------------------------------------------------------|
|                    | (a) if it has an internal audit function, how the function is structured and what role it performs; or  
<p>|                    | (b) if it does not have an internal audit function, that fact and the processes it employs for evaluating and continually improving the |</p>
<table>
<thead>
<tr>
<th>Recommendation 7.4</th>
<th>A listed entity should disclose whether it has any material exposure to economic, environmental and social sustainability risks and, if it does, how it manages or intends to manage those risks.</th>
</tr>
</thead>
</table>

**Principle 8: Remunerate fairly and responsibly**

A listed entity should pay director remuneration sufficient to attract and retain high quality directors and design its executive remuneration to attract, retain and motivate high quality senior executives and to align their interests with the creation of value for security holders.

**Recommendations**

| Recommendation 8.1 | The board of a listed entity should:  
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<td></td>
<td>(a) have a remuneration committee which:</td>
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<td>o has at least three members, a majority of whom are independent directors; and</td>
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<td></td>
<td>o is chaired by an independent director, and disclose:</td>
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<td></td>
<td>o as at the end of each reporting period, the number of times the committee met throughout</td>
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<td></td>
<td>the period and the individual attendances of the members at those meetings; or</td>
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<td></td>
<td>(b) if it does not have a remuneration committee, disclose that fact and the processes it</td>
</tr>
<tr>
<td></td>
<td>employs for setting the level and composition of remuneration for directors and senior</td>
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<td>executives and ensuring that such remuneration is appropriate and not excessive.</td>
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</table>

| Recommendation 8.2 | A listed entity should separately disclose its policies and practices regarding the       |
|--------------------| remuneration of non-executive directors and the remuneration of executive directors and   |
|                    | other senior executives.                                                                  |

| Recommendation 8.3 | A listed entity which has an equity-based remuneration scheme should:                     |
|--------------------| (a) have a policy on whether participants are permitted to enter into transactions (whether |
|                    | through the use of derivatives or otherwise) which limit the economic risk of participating |
|                    | in the scheme; and                                                                        |
|                    | (b) disclose that policy or a summary of it.                                               |

On 2 May 2018, the ASX Corporate Governance Council issued a consultation paper and draft version for a proposed 4th edition of its Corporate Governance Principles and Recommendations. The draft retains the same eight core principles covering the same broad governance themes as the third edition. The fourth edition addresses a number of issues including corporate culture and values, gender diversity, whistleblower policies, anti-bribery and corruption, management processes, diversity and professional development.

**CORPORATE GOVERNANCE IN SINGAPORE**

Corporate governance frameworks and mechanisms are generally targeted at improving a company's
efficiency and/or providing greater transparency and accountability to shareholders and other stakeholders.

The SGX-ST Listing Manual, applies to companies listed on the bourse of the Singapore Exchange Securities Trading Ltd.

The Listing Manual in Singapore requires listed companies to describe in company's Annual Reports their corporate governance practices with specific reference to the principles of the Code of Corporate Governance, as well as disclose and explain any deviation from any guideline of the Code. Companies should make a positive confirmation at the start of the corporate governance section of the company's Annual Report that they have adhered to the principles and guidelines of the Code, or specify each area of non-compliance.

**Code of Corporate Governance:** The Code was first issued by the Corporate Governance Committee in 2001. Compliance with the Code is not mandatory but listed companies are required under the Singapore Exchange Listing Rules to disclose their corporate governance practices and give explanations for deviations from the Code in their annual reports.


The Code of Corporate Governance came under the purview of MAS and SGX with effect from 1st September 2007 to clarify and streamline responsibilities for corporate governance matters for listed companies, bringing it under the sectoral regulator.

The Corporate Governance Council conducted a comprehensive review of the Code, and submitted its recommendations to MAS in 2011.

MAS issued a revised Code of Corporate Governance on May 2012. The 2012 Code of Corporate Governance superseded and replaced the Code that was issued in July 2005. The Code was effective in respect of Annual Reports relating to financial years commencing from 1 November 2012.

Below are the main principles of the Code of Corporate Governance, 2012 -

<table>
<thead>
<tr>
<th>No.</th>
<th>Heading</th>
<th>Principle</th>
</tr>
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<tbody>
<tr>
<td>1.</td>
<td>The Board's Conduct of Affairs</td>
<td>Every company should be headed by an effective Board to lead and control the company. The Board is collectively responsible for the long-term success of the company. The Board works with Management to achieve this objective and Management remains accountable to the Board.</td>
</tr>
<tr>
<td>2.</td>
<td>Board Composition And Guidance</td>
<td>There should be a strong and independent element on the Board, which is able to exercise objective judgement on corporate affairs independently, in particular, from Management and 10% shareholders. No individual or small group of individuals should be allowed to dominate the Board's decision making.</td>
</tr>
<tr>
<td>3.</td>
<td>Chairman And Chief Executive Officer</td>
<td>There should be a clear division of responsibilities between the leadership of the Board and the executives responsible for managing the company's business. No one individual should represent a considerable concentration of power.</td>
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<tr>
<td>4.</td>
<td>Board Membership</td>
<td>There should be a formal and transparent process for the appointment and re-appointment of directors to the Board.</td>
</tr>
<tr>
<td>5.</td>
<td>Board Performance</td>
<td>There should be a formal annual assessment of the effectiveness of the Board as a whole and its Board Committees and the contribution by each director to the effectiveness of the Board.</td>
</tr>
<tr>
<td>6.</td>
<td>Access To Information</td>
<td>In order to fulfil their responsibilities, directors should be provided with complete, adequate and timely information prior to Board Meetings and on an on-going basis so as to enable them to make informed decisions to discharge their duties and responsibilities.</td>
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<tr>
<td>7.</td>
<td>Procedures For Developing Remuneration Policies</td>
<td>There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his own remuneration.</td>
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<tr>
<td>8.</td>
<td>Level and Mix of Remuneration</td>
<td>The level and structure of remuneration should be aligned with the long-term interest and risk policies of the company, and should be appropriate to attract, retain and motivate (a) the directors to provide good stewardship of the company, and (b) key management personnel to successfully manage the company. However, companies should avoid paying more than is necessary for this purpose.</td>
</tr>
<tr>
<td>9.</td>
<td>Disclosure on Remuneration</td>
<td>Every company should provide clear disclosure of its remuneration policies, level and mix of remuneration, and the procedure for setting remuneration, in the company's Annual Report. It should provide disclosure in relation to its remuneration policies to enable investors to understand the link between remuneration paid to directors and key management personnel, and performance.</td>
</tr>
<tr>
<td>10.</td>
<td>Accountability</td>
<td>The Board should present a balanced and understandable assessment of the company's performance, position and prospects.</td>
</tr>
<tr>
<td>11.</td>
<td>Risk Management and Internal Controls</td>
<td>The Board is responsible for the governance of risk. The Board should ensure that Management maintains a sound system of risk management and internal controls to safeguard shareholders' interests and the company's assets, and should determine the nature and extent of the significant risks which the Board is willing to take in achieving its strategic objectives.</td>
</tr>
<tr>
<td>12.</td>
<td>Audit Committee</td>
<td>The Board should establish an Audit Committee (&quot;AC&quot;) with written terms of reference which clearly set out its authority and duties.</td>
</tr>
<tr>
<td>13.</td>
<td>Internal Audit</td>
<td>The company should establish an effective internal audit function that is adequately resourced and independent of the activities it</td>
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</table>
Lesson 1  =  Conceptual framework of Corporate Governance

<table>
<thead>
<tr>
<th></th>
<th>Shareholder Rights</th>
<th>Communication with Shareholders</th>
<th>Conduct of Shareholder Meetings</th>
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<tr>
<td>14.</td>
<td>Companies should treat all shareholders fairly and equitably, and should recognise, protect and facilitate the exercise of shareholders’ rights, and continually review and update such governance arrangements.</td>
<td>Companies should actively engage their shareholders and put in place an investor relations policy to promote regular, effective and fair communication with shareholders.</td>
<td>Companies should encourage greater shareholder participation at general meetings of shareholders, and allow shareholders the opportunity to communicate their views on various matters affecting the company.</td>
</tr>
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</table>

In January 2018, the Singapore Corporate Governance Council (Council) released a consultation paper on its recommendations to revise the Code of Corporate Governance (Code).

Some of the recommendations are as under:

- Lowering the shareholding threshold in relation to determining director independence from 10% to 5%.
- Subjecting the appointment of independent directors who have served beyond 9 years to an annual vote to be approved by the majority of all shareholders and the majority of non-controlling shareholders.
- A revision to the Code for companies to disclose the relationship between remuneration and value creation.
- Disclose the names and remuneration of employees who are substantial shareholders or immediate family of substantial shareholders, where such remuneration exceeds S$100,000 in bands no wider than S$100,000.
- Maintain a current corporate website to provide material updates for all stakeholders in a timely manner.

**MANAGEMENT VS. OWNERSHIP**

The shareholders vest control of the business in the board of directors, who employ specialist management to run the business and return the profits of the business back to the shareholders.

Company law's central dilemma has been the separation of ownership and control in companies. On one side are shareholders, the ostensible owners; on the other side are corporate officers, the shareholders' ostensible fiduciaries. Between them is the board of directors.

Theoretically, shareholders own the company and hence the company ought to be work according to the dictates of the shareholders. However, it is not practically possible for each shareholder to participate in the decision making process on a day-to-day basis. Further shareholders generally cannot know and manage the full details of a corporation's business (nor do many wish to), they elect a board of directors to make broad corporate policy.
Companies allow for the separation of ownership and management. That means that owners do not need to be managers and managers do not need to be owners. In most small corporations, the owners typically manage the company but it is not necessary that owners run the company or are even involved in the day-to-day operations of the company.

Management and owners may have different views on various issues in the company. Managers fear risk more than shareholders do because managers cannot diversify their investment of human capital as shareholders can diversify their investments of money. Managers, therefore, pursue growth rather than maximum share value. Whereas, shareholders prefer high leverage because it increases share values.

**MAJORITY RULE VS. MINORITY**

As a company is an artificial person with no physical existence, it functions through the instrumentality of the board of directors who is guided by the wishes of the majority, subject, of course, to the welfare of the company as a whole. It is, therefore, a cardinal rule of company law that prima facie a majority of members of the company are entitled to exercise the powers of the company and generally to control its affairs.

The rule of majority was established way back in 1843 in the case of Foss v. Harbottle [1843] 67 ER 189 wherein it was held that the Courts would not generally interfere with the decisions of the company which it was empowered to take insofar they had been approved of by the majority and made exceptions to breaches of charter documents, fiduciary duties and frauds or oppression and inadequate notice to the shareholders.

In India, the Companies Act, 2013 and SEBI (LODR) Regulations, 2015 contain various provisions in order to protect the interest of the minority shareholders and their rights which can be considered as a game changer in the tussle between the majority and minority shareholders. The following are the various sections which deal with the minority shareholders under the Companies Act, 2013.

- Oppression & Mismanagement [Sections 241-246]
- Class Action Suits [Section 245]
- Appointment of director by small shareholders (Section 151)
- Promoting the confidence of minority shareholders (Schedule IV - Code for Independent Directors)

The SEBI (LODR) Regulations cast a duty on listed entity, to protect and facilitate the exercise of the rights of shareholders including protection of minority shareholders from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and effective means of redress. Further, the listed entity should ensure equitable treatment of all shareholders, including minority and foreign shareholders.

On analysis of the provisions of the Companies Act, 2013 and SEBI (LODR) Regulations, it is apparent that the legislative intent is to protect and safeguard the minority interest. Minority interest cannot be viewed as a management problem and it should be given due recognition and importance. The principle of majority rule cannot be used to deprive the minority shareholders and their rights. At the same time, it should not be forgotten that the principle envisaged in Foss v. Harbottle is still relevant and the Court was right in ruling that every shareholder is bound by the terms and conditions of incorporation of the company, which operated as a set of mutually binding obligations. However, in the process of implementing the objectives of the company, one should not override the legitimate expectations of the shareholders/parties under the contract. Thus, it can be concluded that the minority's rights need to be looked into with great care and caution so much so that the principle of majority rule should not jeopardise the freedom available to the minority shareholders under the corporate governance regime.
In a latest judgment by Supreme Court, upholding the landmark judgement passed by Madras High Court (HC), ordered S V Global (SVG) Mill, which was carved out of the 200-year-old textiles major Binny, to pay Rs 100 crore to minority shareholders to buy them out.

The minority shares are owned by S Natarajan, one of the original promoters of Binny, and his associates. “This court, under Article 142 of the Constitution, directs that a sum of Rs 100 crore be paid, to the respondents (associates of Natarajan) for the buyout of all the respondents’ shares in the company,” Justice R F Nariman and Justice A M Sapre said in their order.

The shares owned by the minority shareholders, which aggregates to about 42.36 lakh shares or about 19% of share capital of the company, should be purchased within a period of nine months from the date of the order.

CORPORATE GOVERNANCE IN INDIAN ETHOS

The concept of corporate governance in India has ancient connections. There is a great deal of similarity in the governance structures of the ancient kingdoms and modern corporations as is evident from our ancient text and scriptures like Vedas, Manu Smriti, Somadevaneetistuti, Baharaspataya Neetistuti, Arthashastra etc. which focuses on good governance. All Upanishads, Vedas, and the Epic Kavyas like Mahabharata, Ramayana and Bhagwad Gita emphasize the essence of ethics being followed from within, be it Individual or be it the King or be it the whole kingdom. Further, all religious teachings or philosophical writing contain some directives on governance.

Ramayana: The Ramayana, the saga of Rama’s life written by Valmiki, is widely acclaimed as among the greatest of all Indian epics. In fact, this famous Grantha carries useful tips on ethics and values, statecraft and politics, and even general and human resources management. With Rama Rajya as a model for good governance, the Ramayana is a must read for practitioners of statecraft.

The Ayodhya Kanda, the second chapter, contains comprehensive lessons on good governance. When Bharata, the younger brother of Rama, goes to meet the latter in the forest to request him to return to Ayodhya and rule, the two brothers enter into a long and instructive dialogue. Rama counsels Bharata on governance. From quality of ministers and the importance of strategy sessions, to temperance in administration to justice, Rama expounds on all the subtleties of statecraft in a lucid manner. Apparently, Rama seems to be inquiring of Bharata his well-being, whether all is well at Ayodhya - in fact, however, in the process, the lessons on effective governance are offered in a powerful manner. A critical factor in good governance is the quality of ministers. Rama asks Bharata whether he has appointed courageous, knowledgeable, strong-willed men with a high emotional quotient as his ministers, because quality advice is the key to effective governance.

The emphasis is on competence and confidentiality. Rama's advice to Bharata is to take a decision on a complex issue neither unilaterally nor in consultation with too many people. There should be an efficient core group. A good administrator can ensure high returns from minimum investments. Rama tells Bharata to prefer one wise man to a thousand fools as it is the wise that can ensure prosperity during an economic crisis. Even if there is one minister who is really effective, the king will gain immensely. Appointing tested men of noble lineage and integrity for strategic positions is the key to successful government. Moderate taxes should be levied on the people, lest they revolt. Rama wants Bharata to treat his soldiers well and pay their legitimate wages on time. Delays in payment of wages and other allowances that make the soldiers disturb and depress which can lead to dangerous consequences. Trade and agriculture are important and Rama wants Bharata to ensure good irrigation facilities rather than being overly dependent on rains. Traders need to be ensured of a fear-free environment and their grievances should be redressed promptly. Protecting the forests and maintaining livestock have also been dealt with as important aspects of effective governance.
In fact, the vision of the Ramayana has eternal relevance. Law and justice, finance and business, corruption framing of innocents for monetary gains, injustice to the poor are all mentioned. Rama’s words of advice to Bharata are as relevant today as they were in the ancient period. For the benefit of present and future generations, Rama gave valuable tips to Bharata on good governance.

**Bhagwad Gita:** In Bhagwad Gita, Lord Krishna details the divine treasure as fearlessness, purity of heart, steadfastness in knowledge and yoga, charity, self control, and sacrifice, study of scriptures, austerity and uprightness. The Bhagavad Gita emphasized the concept of duty and its importance for good leadership. In the Bhagavad Gita, Lord Krishna motivates and encourages leaders who govern to do their duties and not to run away from the duties as he asserted that leaders should perform their prescribed duty, for doing so is better than not working. Besides, one cannot even maintain one’s physical body without work. Lord Krishna further stressed that duty needs to be done without attachment and for those who do their duty without attachment will attain the supreme goal. By doing their duties without attachment, the leaders also set examples for their people. Lord Krishna asserted that whatever the leader does, the people will follow and whatever standards or example the leader sets people in general will follow. It is therefore imperative; leaders need to perform their work (duty) in governing effectively for the sake of educating the people in general (leadership by example). This has a great implication for sustainable development as it is a must for leaders to practice what they preach.

**Arthashastra**

Kautilya’s Arthashastra maintains that for good governance, all administrators, including the king are considered servants of the people. Good governance and stability are completely linked. If rulers are responsive, accountable, removable, recallable, there is stability. If not there is instability. These tenets hold good even today.

<table>
<thead>
<tr>
<th><strong>Kautilya’s fourfold duty of a king—</strong></th>
<th>The substitution of the state with the corporation, the king with the CEO or the board of a corporation, and the subjects with the shareholders, bring out the quintessence of corporate governance, because central to the concept of corporate governance is the belief that public good should be ahead of private good and that the corporation's resources cannot be used for personal benefit.</th>
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<tbody>
<tr>
<td>Raksha, vridhi, palana, Yogakshema.</td>
<td><strong>Raksha</strong> – literally means protection, in the corporate scenario it can be equated with the risk management aspect.</td>
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<td></td>
<td><strong>Vriddhi</strong> – literally means growth, in the present day context can be equated to stakeholder value enhancement</td>
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<tr>
<td></td>
<td><strong>Palana</strong> – literally means maintenance/compliance, in the present day context it can be equated to compliance to the law in letter and spirit.</td>
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<tr>
<td></td>
<td><strong>Yogakshema</strong> – literally means well being and in Kautilya’sArthashastra it is used in context of a social security system. In the present day context it can be equated to corporate social responsibility.</td>
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</tbody>
</table>

Arthashastra talks self-discipline for a king and the six enemies which a king should overcome – lust, anger, greed, conceit, arrogance and foolhardiness. In the present day context, this addresses the ethics aspect of businesses and the personal ethics of the corporate leaders.

Kautilya asserts that “A king can reign only with the help of others; one wheel alone does not move a chariot. Therefore, a king should appoint advisors (as councilors and ministers) and listen to their advice.”
“The opinion of advisers shall be sought individually as well as together [as a group]. The reason why each one holds a particular opinion shall also be ascertained.”

Kautilya has emphasized on the imperatives of the king and his counselors acting in concert. Cohesion is key to the successful functioning of a board and the company it directs. A board that contributes constructively to sustainable success but does not compromise on the integrity and independence of the non-executive directors is the most desirable instrument of good corporate governance.

“If the king and his counselors do not agree on the course of action, it spells future trouble, irrespective of whether the venture is crowned with success or ends in failure.” There could be no stronger counsel relevant to modern day corporate governance structures for executive managements to heed the advice given by the non-executive independent colleagues on the board of directors.

Balancing the interests of the various stakeholders is again at the core of good corporate governance, is highlighted in the Arthashastra and the other ancient texts. There is no prescription in the scriptures that the interests of only selected few need to be the concern of the king. This generic approach to an across-the-board welfare of all the citizens in the kingdom lends credence also to the modern theories of corporate accountability to a wider group of stakeholders, than merely to a single component thereof comprising shareholders.

Corporate Governance is managing, monitoring and overseeing various corporate systems in such a manner that corporate reliability, reputation are not put at stake. Corporate Governance pillars on transparency and fairness in action satisfying accountability and responsibility towards the stakeholders.

The long term performance of a corporate is judged by a wide constituency of stakeholders. Various stakeholders affected by the governance practices of the company:
Teachings of Lord Buddha & Jain Sutra: Lord Buddha also propounded five principles, which were known as panchsheel. These five principles are non-violence, truth, non-stealing, celibacy and non-intoxication. In the 23rd chapter of the Uttaradhyayana Sutra, Kesi Gautama discusses the five teachings of Lord Mahavira. There is no difference between panchsheel and these five teachings.

Mahabharata: Shanti Parva which is the part of Indian Epic Mahabharata recites the duties of the ruler, dharma and good governance, as counselled by the dying Bhishmato Yudhishthira and various Rishis. Shanti parva recites a theory of governance and duties of a leader. The Shanti parva dedicates over 100 chapters on duties of a king and rules of proper governance. A prosperous kingdom must be guided by truth and justice. The duty of a ruler and his cabinet is to enable people to be happy, pursue truth and act sincerely. The proper function of a ruler is to rule according to dharma; he should lead a simple life and he should not use his power to enjoy the luxuries of life. Shanti parva asserts rulers have a dharma (duty, responsibility) to help the upliftment of all living beings. The best law, claims Shanti parva, is one that enhances the welfare of all living beings, without injuring any specific group.

A great Tamil poet also gave a wonderful advice to the King of her time about how the King can achieve fame. In a beautifully described phenomenon of ‘bottom up glory’ years ago, she said:

“When the height of the boundaries of the paddy field increases, the water level in the field increases;
when the water level increases, the paddy level increases;
when the paddy level increases, the quality of life increases;
when the quality of life increases, the quality of governance increases;
and when the quality of governance increases, the country flourishes and the greatness of those who govern admired.”

The dynasty kingdom is history now, though it exists in politics and business. The vacuum created by the phasing out of the King rule and the kingdom has been slowly and steadily filled by the corporate houses of today. The corporate houses are equivalent to the dynasty kingdom in addition to other kingdoms in other area like politics, culture etc. Thus, the principles which applied to the Kings and Rulers of the dynasty Kingdom simply apply to the organisation and their management which manages the organisation. The principle of good governance what was talked of during the ancient period is that which is gaining more prominence today.

CORPORATE GOVERNANCE AND FAMILY ENTERPRISES

India enjoys a rich and glorious history of family-owned business. A family business may be company, partnership firm, HUF or any other form of business owned, controlled and operated by members of a family. In India the majority of businesses are controlled by families.

According to the Credit Suisse Research Institute’s (CSRI) latest “CS Family 1000” report, India has 108 publicly-listed family-owned businesses, the third highest in the world, while China tops the tally with 167 such companies followed by the US which has 121. Besides China, the US and India, the top 10 countries in terms of number of family-owned companies include France (fourth place), Hong Kong (fifth), Korea (sixth), Malaysia (seventh), Thailand (eighth), Indonesia (ninth), Mexico (10th).

Family businesses are the major form of enterprise in India and across the world, viz. Corporation houses like Suzlon, Tata, Birla, Bajaj, Reliance, Godrej, Ford Motor, Tetra Pak, Wal-Mart, DuPont, Cadbury, Acer Computers were started as family business. Several studies indicate that family business carry the weight of economic wealth creation in all economies.
Most family businesses do not survive beyond two or three generations. One of the main reasons for the short life span of family businesses is due to the lack of governance mechanisms in the family. With better family governance, business development reaches next level and ensures continuity of the business across generations.

**Family Business and Economy**

Business is as old as civilisation itself. No development could have taken place worldwide in absence of the business. For historical, evolutionary reasons, most countries have family businesses constituting the largest category in terms of ownership. About one third of the companies listed in Fortune 500 are family businesses. Since they normally do not have short term orientation but are interested in growing the family wealth with necessary precautions and have a different set of strategic goals compared to non-family owned companies, their long term contribution to economy is significant.

Family as a social institution is one of the oldest surviving. Economic liberalisation and rapid expansion in the industrial base in recent years have not only created growth opportunities for many but also have tested their resource capabilities to respond to them; some have chosen to follow the role of a custodian of their existing wealth and followed the preservation route, while some others have followed more of an entrepreneurial route of exploiting opportunities with or without relevant resources, with mixed results. One of the key resources for all of them is their family, and their prime concern is wealth and welfare of their family.

Family Business contributes a significant percent of GDP of most of the countries. As new generations join the family business, it is an enormous challenge to keep the family & business together. It has been observed that some of the Family businesses survive till 3rd generation & very few go beyond third generation and many business families disintegrate because of generational conflict. However, the close-knit structure of families, which fosters teamwork combined with respect to family values and family elders, has been the key to success of many family businesses.

**The Paradigm Shift**

A visible change can be observed in the family businesses in India. Old family business houses are changing to “professionally managed” companies. The younger successors have a broad vision and global aspirations. They prefer working with modern management techniques, build competent teams, and create transparent systems and processes. Instead of getting stalled in family conflicts, disputes, and non-productive practices, the younger generation prefers to create a professional work culture.

Family businesses are operated with the ethos of “Family First”. Business decisions are taken while keeping the family’s wellbeing in focus. With changing preferences of the next-generation successors, it is possible to balance the family’s philosophy, culture and personal needs with business performance, profit and transparency.

One fact to be proud of is that despite their large shareholding, the family promoters, considered themselves as trustees of public wealth. Their fiduciary duty includes the following:

- Upholding three values of Corporate Governance i.e. accountability, honesty and transparency
- Upholding primary loyalty
- Protecting minority owners’ interest
- Learning, developing and communicating
- Fulfilling corporate social responsibility
Family & Non-Family Executives

Professionalisation of a family business is of supreme importance for its long-term sustainability. In absence of professionalism, a family business may get frequently weighed down with conflicts due to lack of clarity and systematic work processes, role confusion and informal organisation structure. Poor accountability and improper operations control severely interrupts efficiency of business. The business also fails to attract and retain good external talent.

The relationship between non-family executives and family members involved in business is found to be smooth when the family members earn professional respect from outsiders. In family businesses where management delegation to outside professionals is very high, leaving limited space for the new generation to enter, there is greater possibility for entrepreneurship to flourish among young generation.

Family executives involved in business also need to be equipped with modern management techniques. They must develop a team of management professionals, formalize work procedures, delegate work with proper control mechanisms. The challenge here is to ensure that the core values and spirit of the family are not stifled due to professionalization.

The performance of top management depends on its relationship with its principals, the shareholders. In family business, compared to others, most often the promoter family would be the largest shareholder. Families with the clear vision would always have their mind shared with the executives about their expectations. This is true whether the family members are involved in business or not. This could be one reason why the performance of family run business is found to be higher than non family business.

Advantages and Challenges of Family Enterprises

Some of the advantages that family businesses share over non-family enterprises include the following:

- It is believed that owners tend to take better care of their businesses as they have greater personal stakes involved.
- Not having responsibilities towards any shareholders gives the family businesses greater flexibility in terms of making decisions faster, improving the speed with which they launch new initiatives, change operations, evaluate new business opportunities, etc.
- Family businesses gain significant experience and expertise as they typically work in one industry for longer durations.
- Family businesses thrive on mutual trust and believe in maintaining long-term relationships by providing a conducive, supportive and trusting work environment.
- Family businesses believe they are more entrepreneurial, they create more jobs and are able to adjust or reinvent their business to suit each generation.

Family businesses also acknowledge the challenges while comparing themselves to non-family businesses. Following are the key downsides faced by family businesses:

- Attracting key employees in a business that has obvious limitations for advancement for a non-family member is a daunting issue.
- External talent can be reluctant to join the family businesses as they would not enjoy the same freedom that the other businesses offer. Also, the top positions being held by family members prove as a deterrent.
• Access to capital is required to grow and evolve. However, some family businesses feel that this is a harder challenge for them than for the non-family businesses.

• Managing the diverse opinions and views of other family members in the business can be an issue.

• Separating the ownership from the management and reaching a consensus on the roles of family members in the business are two important issues for the family businesses to address.

Some Unique challenges/ Governance issues of family businesses:

• Managing the diverse opinions of family members in the business, solving internal issues and disputes, etc is a challenge.

• Investors—both shareholders and creditors—may look with distrust on family-controlled companies, because of the risk that the controlling family may abuse the rights of other shareholders. So investors likely to scrutinize such companies with care before taking the plunge and investing.

• There are also challenges of multiple stakeholders for the leadership position. Very often, there is lack of communication between the incumbent and incoming generations. The incumbents do not know how to handle the succession challenge, while the incoming generation does not know how to raise it. The families should choose their most competent member(s) to manage the business, disregarding age, gender or bloodline. However, post-succession role of the incumbent is not often planned leading to complications.

• Hiring external staff which may perceive that career advancement, freedom and decision-making are solely the purview of family.

• Although ownership and management succession are the key concerns of a large number of business families, they do not devote enough attention to the process involved. Succession dilemma is also closely related to the family policy on entry of new generation, retirement of incumbents and mechanisms for resolving conflicts. Entry of new members from the family depends also on the ‘space’ available in the organization, which in turn depends on the success of the business. The younger generation may face difficulties in proving themselves to the former generation.

• Change in mind-set: Differing views between the older generation and the newer generation

• Lack of Competitiveness: Another source of challenge is in the nature of competitiveness. For instance, when the Indian economy was opened up in 1991, most Indian companies, of which a huge majority were family owned, were put under competitive pressures for the first time. Many firms, particularly those that grew under government protection did not have a strategy to respond and took it as a threat rather than opportunity for a variety of reasons. This created huge tensions in business families, sometimes leading to division of assets.

### GLOSSARY OF TECHNICAL WORDS

- **Governance**: relates to “the processes of interaction and decision-making among the actors involved in a collective problem that lead to the creation, reinforcement, or reproduction of social norms and institutions.”

- **Corporate Performance**: is a composite assessment of how well an organization executes on its most important parameters, typically financial, market and shareholder performance.

- **Triple Bottom Line**: is an accounting framework with three parts: social, environmental and financial. Organizations have adopted the TBL framework to evaluate their performance in a broader perspective to create greater business value.
- **Non-executive Director**: is a member of a company’s board of directors who is not part of the executive team. A non-executive director typically does not engage in the day-to-day management of the organization, but is involved in policymaking and planning exercises.

- **Sarbanes Oxley Act**: An American federal law, 2002, which substantially revised and strengthened securities laws and their administration in the aftermath of high profile corporate accounting scandals such as that involving Enron.

## LESSON ROUND UP

- The root of the word Governance is from ‘gubernate’, which means to steer. Corporate governance would mean to steer an organization in the desired direction. The responsibility to steer lies with the board of directors/governing board. Governance is concerned with the intrinsic nature, purpose, integrity and identity of an organization with primary focus on the entity’s relevance, continuity and fiduciary aspects.

- **Corporate Governance Basic theories**: Agency Theory; Stock Holder Theory; Stake Holder Theory; Stewardship Theory.

- Since the majority of the members are in an advantageous position to run the company according to their command, the minority shareholders are often oppressed. The corporate governance provide for adequate protection for the minority shareholders when their rights are trampled by the majority.

- OECD has defined corporate governance to mean “A system by which business corporations are directed and controlled”. Corporate governance structure specifies the distribution of rights and responsibilities among different participants in the company such as board, management, shareholders and other stakeholders; and spells out the rules and procedures for corporate decision making. By doing this, it provides the structure through which the company’s objectives are set along with the means of attaining these objectives as well as for monitoring performance.

- The initiatives taken by Government of India in 1991, aimed at economic liberalisation and globalisation of the domestic economy, led India to initiate reform process in order to suitably respond to the developments taking place world over. On account of the interest generated by Cadbury Committee Report, the Confederation of Indian Industry (CII), the Associated Chambers of Commerce and Industry (ASSOCHAM) and, the Securities and Exchange Board of India (SEBI) constituted Committees to recommend initiatives in Corporate Governance.

- As per CII “Corporate governance deals with laws, procedures, practices and implicit rules that determine a company’s ability to take informed managerial decisions vis-à-vis its claimants - in particular, its shareholders, creditors, customers, the State and employees. There is a global consensus about the objective of ‘good’ corporate governance: maximising long-term shareholder value.”

- The Kumar Mangalam Birla Committee constituted by SEBI has observed that: “Strong corporate governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure.”

- N.R. Narayana Murthy Committee on Corporate Governance constituted by SEBI has observed that: “Corporate Governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company.”

- The Institute of Company Secretaries of India has also defined the term Corporate Governance to mean “Corporate Governance is the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders.”
• Initiated by Cadbury Committee, corporate governance has grown multifold in UK. UK Corporate Governance Code, 2016 is a revised version of earlier code with few new recommendations.

• With the introduction of Sarbanes–Oxley Act, 2002 Corporate Governance practices have been fundamentally altered – auditor independence, conflict of interests, financial disclosures, severe penalties for willful default by managers and auditors in particular. The Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010 has given an opportunity to shareholders to hold accountable executives of the companies they own.

• Good governance is integral to the very existence of a company. It inspires and strengthens investor’s confidence by ensuring company’s commitment to higher growth and profits.

• Corporate Governance extends beyond corporate law. Its fundamental objective is not mere fulfillment of the requirements of law but in ensuring commitment of the Board in managing the company in a transparent manner for maximizing stakeholder value. The real onus of achieving desired levels of corporate governance lies with corporates themselves and not in external measures.

• Ancient Indian scriptures contain learning on governance. Kautilya’s Arthashastra maintains that for good governance, all administrators, including the king were considered servants of the people. Good governance and stability were completely linked. There is stability if leaders are responsive, accountable and removable. These tenets hold good even today.

**SELF TEST QUESTIONS**

1. Discuss in brief the evolution of the concept of Corporate Governance in U.K.
2. Discuss briefly the Corporate Governance developments in India.
3. Explain why Corporate Governance is gaining importance.
4. What are the elements of Good Corporate Governance?
5. What are the Basic theories of Corporate Governance?
Lesson 2
Legislative Framework of Corporate Governance in India

LESSON OUTLINE

- Introduction
- Principles for periodic disclosures and for corporate governance
- Provisions of Corporate governance under Companies Act 2013 and SEBI (LODR) Regulations, 2015
- Disclosure and Transparency requirements under Companies Act 2013 and SEBI Regulations
- Disclosure requirements under SEBI (Prohibition of Insider Trading) Regulations, 2015
- Related Party Transactions
- Vigil Mechanism
- Glossary
- Lesson Round-Up
- Self Test Questions

LEARNING OBJECTIVES

The objective of this study lesson is to enable the students to understand the legal framework in India supporting/enforcing corporate governance practices in terms of transparency, disclosure, accountability, integrity, etc.

Legislative aspects pertaining to various corporate governance requirements like Board Structure, Composition, Board Meetings, Powers of the Board, Committees, Independent Directors, Transparency and Disclosure highlighting the relevant provisions of Companies Act, and SEBI (LODR) Regulations, 2015 are discussed in this lesson.

This chapter provides working knowledge for application of principles, theory and concepts of Corporate Governance in India. This chapter may also be useful in performing the advisory role and in compliance management in practical areas of work.

“A well balanced, inclusive approach, according to certain standard and ideals, is essential for the proper governance of any country”
- Laisenia Qarase
INTRODUCTION

The initiatives taken by Government in 1991, aimed at economic liberalization and globalization, led to the need for Indian companies to adopt corporate governance practices and standards, which are consistent with international principles. It led to the introduction of legislative reforms prescribing the manner in which Indian companies could implement effective corporate governance mechanisms.

The developments of corporate governance have been discussed in previous chapters. In India, the Companies Act, 2013 and the SEBI Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015 (also mentioned in this Chapter as Listing Regulations) together deals with virtually all areas affecting corporate governance, which are explained hereunder.

PRINCIPLES FOR PERIODIC DISCLOSURES AND FOR CORPORATE GOVERNANCE

Regulation 4 of the Listing Regulations, 2015 provides for broad principles for periodic disclosures and for corporate governance by listed entities.

(A) **Principles for Periodic Disclosures:** The listed entity which has listed securities shall make disclosures and abide by its obligations under these regulations, in accordance with the following principles:

(a) Information shall be prepared and disclosed in accordance with applicable standards of accounting and financial disclosure.

(b) The listed entity shall implement the prescribed accounting standards in letter and spirit in the preparation of financial statements taking into consideration the interest of all stakeholders and shall also ensure that the annual audit is conducted by an independent, competent and qualified auditor.

(c) The listed entity shall refrain from misrepresentation and ensure that the information provided to recognised stock exchange(s) and investors is not misleading.

(d) The listed entity shall provide adequate and timely information to recognised stock exchange(s) and investors.

(e) The listed entity shall ensure that disseminations made under provisions of these regulations and circulars made thereunder, are adequate, accurate, explicit, timely and presented in a simple language.

(f) Channels for disseminating information shall provide for equal, timely and cost efficient access to relevant information by investors.

(g) The listed entity shall abide by all the provisions of the applicable laws including the securities laws and also such other guidelines as may be issued from time to time by the Board and the recognised stock exchange(s) in this regard and as may be applicable.

(h) The listed entity shall make the specified disclosures and follow its obligations in letter and spirit taking into consideration the interest of all stakeholders.

(i) Filings, reports, statements, documents and information which are event based or are filed periodically shall contain relevant information.

(j) Periodic filings, reports, statements, documents and information reports shall contain
information that shall enable investors to track the performance of a listed entity over regular intervals of time and shall provide sufficient information to enable investors to assess the current status of a listed entity.

The above principles for periodic disclosures are based on the principles given by International Organization of Securities Commissions (IOSCO). IOSCO has framed certain principles of disclosures recognizing that disclosure of reliable, timely information contributes to liquid and efficient markets by enabling investors to make investment decisions based on all the information that would be material to their decisions.

(B) Corporate Governance Principles: The listed entity which has listed its specified securities shall comply with the corporate governance principles under following broad headings- :

(a) The rights of shareholders: The listed entity shall seek to protect and facilitate the exercise of the following rights of shareholders:

(i) right to participate in, and to be sufficiently informed of, decisions concerning fundamental corporate changes.

(ii) opportunity to participate effectively and vote in general shareholder meetings.

(iii) being informed of the rules, including voting procedures that govern general shareholder meetings.

(iv) opportunity to ask questions to the board of directors, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.

(v) effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of board of directors.
(vi) exercise of ownership rights by all shareholders, including institutional investors.

(vii) adequate mechanism to address the grievances of the shareholders.

(viii) protection of minority shareholders from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and effective means of redress.

**b) Timely information:** The listed entity shall provide adequate and timely information to shareholders, including but not limited to the following:

(i) sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be discussed at the meeting.

(ii) Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership.

(iii) rights attached to all series and classes of shares, which shall be disclosed to investors before they acquire shares.

(c) Equitable treatment: The listed entity shall ensure equitable treatment of all shareholders, including minority and foreign shareholders, in the following manner:

(i) All shareholders of the same series of a class shall be treated equally.

(ii) Effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of board of directors, shall be facilitated.

(iii) Exercise of voting rights by foreign shareholders shall be facilitated.

(iv) The listed entity shall devise a framework to avoid insider trading and abusive self-dealing.

(v) Processes and procedures for general shareholder meetings shall allow for equitable treatment of all shareholders.

(vi) Procedures of listed entity shall not make it unduly difficult or expensive to cast votes.

(d) Role of stakeholders in corporate governance: The listed entity shall recognise the rights of its stakeholders and encourage co-operation between listed entity and the stakeholders, in the following manner:

(i) The listed entity shall respect the rights of stakeholders that are established by law or through mutual agreements.

(ii) Stakeholders shall have the opportunity to obtain effective redress for violation of their rights.

(iii) Stakeholders shall have access to relevant, sufficient and reliable information on a timely and regular basis to enable them to participate in corporate governance process.

(iv) The listed entity shall devise an effective whistle blower mechanism enabling stakeholders, including individual employees and their representative bodies, to freely communicate their concerns about illegal or unethical practices.

(e) Disclosure and transparency: The listed entity shall ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the listed entity, in the following manner:

(i) Information shall be prepared and disclosed in accordance with the prescribed standards of
accounting, financial and non-financial disclosure.***

(ii) Channels for disseminating information shall provide for equal, timely and cost efficient access to relevant information by users.

(iii) Minutes of the meeting shall be maintained explicitly recording dissenting opinions, if any.

(f) **Responsibilities of the board of directors:** The board of directors of the listed entity shall have the following responsibilities:

(i) **Disclosure of information:**

(1) Members of board of directors and key managerial personnel shall disclose to the board of directors whether they, directly, indirectly, or on behalf of third parties, have a material interest in any transaction or matter directly affecting the listed entity.

(2) The board of directors and senior management shall conduct themselves so as to meet the expectations of operational transparency to stakeholders while at the same time maintaining confidentiality of information in order to foster a culture of good decision-making.

(ii) **Key functions of the board of directors:**

(1) Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans, setting performance objectives, monitoring implementation and corporate performance, and overseeing major capital expenditures, acquisitions and divestments.

(2) Monitoring the effectiveness of the listed entity’s governance practices and making changes as needed.

(3) Selecting, compensating, monitoring and, when necessary, replacing key managerial personnel and overseeing succession planning.

(4) Aligning key managerial personnel and remuneration of board of directors with the longer term interests of the listed entity and its shareholders.

(5) Ensuring a transparent nomination process to the board of directors with the diversity of thought, experience, knowledge, perspective and gender in the board of directors.

(6) Monitoring and managing potential conflicts of interest of management, members of the board of directors and shareholders, including misuse of corporate assets and abuse in related party transactions.

(7) Ensuring the integrity of the listed entity’s accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.

(8) Overseeing the process of disclosure and communications.

(9) Monitoring and reviewing board of director’s evaluation framework.

(iii) **Other responsibilities:**

(1) The board of directors shall provide strategic guidance to the listed entity, ensure effective monitoring of the management and shall be accountable to the listed entity and the shareholders.

(2) The board of directors shall set a corporate culture and the values by which executives throughout a
group shall behave.

(3) Members of the board of directors shall act on a fully informed basis, in good faith, with due
diligence and care, and in the best interest of the listed entity and the shareholders.

(4) The board of directors shall encourage continuing directors training to ensure that the members of
board of directors are kept up to date.

(5) Where decisions of the board of directors may affect different shareholder groups differently, the
board of directors shall treat all shareholders fairly.

(6) The board of directors shall maintain high ethical standards and shall take into account the interests
of stakeholders.

(7) The board of directors shall exercise objective independent judgement on corporate affairs.

(8) The board of directors shall consider assigning a sufficient number of non-executive members of the
board of directors capable of exercising independent judgement to tasks where there is a potential
for conflict of interest.

(9) The board of directors shall ensure that, while rightly encouraging positive thinking, these do not
result in over-optimism that either leads to significant risks not being recognised or exposes the
listed entity to excessive risk.

(10) The board of directors shall have ability to ‘step back’ to assist executive management by
challenging the assumptions underlying: strategy, strategic initiatives (such as acquisitions), risk
appetite, exposures and the key areas of the listed entity’s focus.

(11) When committees of the board of directors are established, their mandate, composition and working
procedures shall be well defined and disclosed by the board of directors.

(12) Members of the board of directors shall be able to commit themselves effectively to their
responsibilities.

(13) In order to fulfil their responsibilities, members of the board of directors shall have access to
accurate, relevant and timely information.

(14) The board of directors and senior management shall facilitate the independent directors to perform
their role effectively as a member of the board of directors and also a member of a committee of
board of directors.

### PROVISIONS OF CORPORATE GOVERNANCE UNDER COMPANIES ACT, 2013 AND SEBI
(LODR) REGULATIONS, 2015

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<tr>
<th>Sl No</th>
<th>Particulars</th>
<th>Companies Act, 2013</th>
<th>SEBI (LODR) Regulations, 2015</th>
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| 1     | Size of the Board    | **Section 149(1)**
It stipulates the minimum number of
director as three in case of public
company, two in case of private
company and one in case of One
Person Company. The maximum
number of directors stipulated is 15. |
|       |                      | **Regulation 17(1)(a)**
The board of directors shall have an
optimum combination of executive
and non-executive directors. |
2. **Board Composition**

*Section 149(4)* provides that every public listed company shall have at least one third of total number of directors as independent directors and Central Government may prescribe the minimum number of independent directors in any class or classes of companies.

Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014 prescribes that the following class or classes of companies shall have at least two independent directors:

- Public Companies having paid-up share capital of 10 crore rupees or more; or
- Public Companies having turnover of 100 crore rupees or more; or
- Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding 50 crore rupees.

*Regulation 17(1)*

- At least 50% of the board of directors shall comprise of non-executive directors.
- If the chairperson of the board of directors is a non-executive director, at least 1/3rd of the board of directors shall comprise of independent directors.
- If the chairperson of the board of directors is not a non-executive director, at least 50% of the board of directors shall comprise of independent directors.
- If the regular non-executive chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the level of board of director or at one level below the board of directors, at least 50% of the board of directors of the listed entity shall consist of independent directors.

3. **Appointment of Woman Director**

*Section 149(1) and Companies (Appointment and Qualification of Directors) Rules, 2014*

Rule (3) read with Section 149(1) provides that

(i) every listed company;

(ii) every other public company having -

1. paid-up share capital of Rs.100 crores or more; or
2. turnover of Rs.300 crore or more shall appoint at least one woman director.

Any intermittent vacancy of a woman director shall be filled up by the Board at the earliest but not later

*Regulation 17(1)(a)*

The Board of Directors of the listed entity shall have at least one woman director.

The Board of Directors of top 500 listed entities (with effect from April 1, 2019) and top 1000 listed entities (with effect from April 1, 2020) shall have at least one independent women director.
than immediate next Board meeting or three months from the date of such vacancy whichever is later.

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<td>4.</td>
<td><strong>Maximum No. of directorship of Independent Directors</strong>&lt;br&gt;<strong>Section 165</strong>&lt;br&gt;A person shall not hold office as a director, including any alternate directorship in more than 20 companies at the same time.&lt;br&gt;For reckoning the limit of directorships of 20 companies, the directorship in a dormant company shall not be included.&lt;br&gt;The maximum number of public companies in which a person can be appointed as a director shall not exceed 10.&lt;br&gt;<strong>Regulation 17A</strong>&lt;br&gt;A person shall not serve as an independent director in more than seven listed entities.&lt;br&gt;Any person who is serving as a whole time director in any listed entity shall serve as an independent director in not more than three listed entities.&lt;br&gt;<strong>Regulation 25(1)</strong>&lt;br&gt;No person shall be appointed or continue as an alternate director for an independent of a listed entity w.e.f. 1&lt;sup&gt;st&lt;/sup&gt; October 2018.</td>
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<td>5.</td>
<td><strong>Maximum tenure of Independent Directors</strong>&lt;br&gt;<strong>Section 149(10) &amp; (11)</strong>&lt;br&gt;Subject to the provisions of Section 152(2), an independent director shall hold office for a term up to five consecutive years on the Board of a company, but shall be eligible for reappointment on passing of a special resolution by the company and disclosure of such appointment in the Board’s report.&lt;br&gt;No independent director shall hold office for more than two consecutive terms, but such independent director shall be eligible for appointment after the expiration of three years of ceasing to become an independent director.&lt;br&gt;<strong>Regulation 25(2)</strong>&lt;br&gt;It shall be in accordance with the Companies Act, 2013 and rules made there under, in this regard, from time to time.</td>
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<td>6.</td>
<td><strong>Performance evaluation of Independent Directors</strong>&lt;br&gt;<strong>Section 178(2) read with Schedule IV</strong>&lt;br&gt;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&lt;br&gt;<strong>Regulation 17(10) and Schedules II &amp; V</strong>&lt;br&gt;The evaluation of independent directors shall be done by the entire board of directors which shall include-&lt;br&gt;(a) performance of the directors; and&lt;br&gt;(b) fulfillment of the independence criteria as specified in these regulations and their independence from the management</td>
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<td><strong>appointment and removal and shall</strong> specify the manner for effective evaluation of performance of Board, its committees and individual directors to be carried out either by the Board, by the Nomination and Remuneration Committee or by an independent external agency and review its implementation and compliance. The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated. 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.</td>
<td>Provided that in the above evaluation, the directors who are subject to evaluation shall not participate.</td>
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<td>7.</td>
<td>Separate meeting of Independent Directors</td>
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<td>8.</td>
<td>Familiarisation Programme for Independent Director</td>
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| **9.** | Prohibited Stock options for Independent Directors | *Section 197(7)*  
Independent Directors shall not be entitled to any stock option. | *Regulation17(6)(d)*  
Independent Directors shall not be entitled to any stock options. |
| **10.** | Filing of Casual Vacancy of Independent Directors | *Schedule IV, Section VI*  
Second proviso to Rule 4 of the Companies (Appointment and Qualifications of Directors) Rules, 2014 states that any intermittent vacancy of an independent director shall be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy, whichever is later.  
An independent director who resigns or is removed from the Board of the company shall be replaced by a new independent director within three months from the date of such resignation or removal, as the case may be.  
Where the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new Independent Director shall not apply. | *Regulation25(6)*  
An independent director who resigns or is removed from the Board of the listed entity shall be replaced by a new independent director at the earliest but not later than the immediate next Board meeting or three months from the date of such vacancy, whichever is later.  
Where the listed entity fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director shall not apply. |
| **11.** | Succession planning | There is no such provision. | *Regulation17(4)*  
The Board of the listed entity shall satisfy itself that plans are in place for orderly succession for appointments to the Board and to senior management. |
| **12.** | Code of Conduct of Board of Directors & Senior Management | *Section 149(8)* provides that the company and the independent directors shall abide by the provisions specified in Schedule IV. | *Regulations17(5)& 26(3)*  
The board shall lay down a code of conduct for all Board members and senior management of the listed entity, which shall be posted on the website of the listed entity. |
### 13. Liability of Independent Directors

**Section 149(12)**

An independent director; a non-executive director not being a promoter or Key Managerial Personnel, shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.

**Regulation 25(5)**

An independent director shall be held liable, only in respect of such acts of omission or commission by a listed entity which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently with respect of the provisions contained in the listing regulations.

Regulation 17(5)(b) states that the Code of Conduct shall suitably incorporate the duties of independent directors as laid down in the Companies Act, 2013.

### 14. Vigil mechanism

**Section 177(9)read with Rule 7 of Companies (Meetings of Board and its Power) Rules, 2014**

Every listed company and the companies which accept deposits from the public or which have borrowed money from banks and public financial institutions in excess of fifty crore rupees shall establish a Vigil mechanism for directors and employees to report genuine concern.

This mechanism should provide for adequate safeguards against victimization of director(s)/employee(s) who avail of the mechanism and also provide for direct access to the chairperson of the Audit Committee in exceptional cases.

The details of establishment of such...
The companies which are required to constitute an audit committee shall oversee the vigil mechanism through the committee and if any of the members of the committee have a conflict of interest in a given case, they should recuse themselves and the others on the committee would deal with matter on hand.

The Vigil Mechanism shall provide adequate safeguards against victimization of employees and directors who avail of the Vigil mechanism and also provide for direct access to the chairperson of the Audit committee or the director nominated to play the role of audit committee, as the case may be, in exceptional cases.

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<th>15. Qualification of Independent Directors</th>
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<td><strong>Rule 5 of Companies (Appointment and Qualification of Directors) Rules, 2014</strong></td>
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<tr>
<td>An independent director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company’s business.</td>
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<td>The qualifications of Independent Directors are not specified in the listed regulation.</td>
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<table>
<thead>
<tr>
<th>16. Constitution of Audit Committee</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Section 177 read with Rule 6 of Companies (Meetings of Board and Its Powers) Rules, 2014</strong></td>
</tr>
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<td>The Board of directors of a public company which is listed, or having paid up share capital of ₹10 crore or more, or having turnover of Rs. 100 crore or more, or which have, in aggregate, outstanding loans, debentures and deposits, exceeding ₹50 crore, shall constitute an Audit Committee.</td>
</tr>
<tr>
<td>Regulation 18</td>
</tr>
<tr>
<td>The listed entity shall constitute a qualified and independent audit committee, giving the terms of reference subject to the following:</td>
</tr>
<tr>
<td>1. The audit committee shall have a minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.</td>
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</table>
| 2. All members of audit committee shall be financially literate and at
### Lesson 2  Legislative framework of Corporate Governance in India

<table>
<thead>
<tr>
<th>17. Constitution of Nomination &amp; Remuneration Committee</th>
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<tbody>
<tr>
<td>The Audit Committee shall consist of a minimum three directors with independent directors forming a majority, provided that majority of members of Audit Committee including its chairperson shall be person with ability to read and understand the financial statement.least one member shall have accounting or related financial management expertise.3. The chairperson of the Audit Committee shall be an Independent Director.</td>
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<td>The Board of directors of a public company which is listed, or having paid up share capital of Rs. 10 crore or more, or having turnover of ₹100 crore or more, or which have, in aggregate, outstanding loans, debentures and deposits, exceeding ₹50 crore, shall constitute a nomination and remuneration committee of the Board.</td>
</tr>
<tr>
<td>The above mentioned companies shall constitute the nomination and remuneration committee consisting of 3 or more non executive directors out of which not less than one half shall be Independent Directors.</td>
</tr>
<tr>
<td>The chairperson of the company (whether executive or non-executive) may be appointed as a member of the nomination and remuneration committee but shall not chair such committee. The role of the committee shall, inter alia, include the following:</td>
</tr>
<tr>
<td>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;</td>
</tr>
<tr>
<td>2. Formulation of criteria for evaluation of Independent Directors and the Board;</td>
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<tr>
<td>3. Devising a policy on Board diversity;</td>
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</thead>
<tbody>
<tr>
<td><strong>Regulation 19</strong></td>
</tr>
<tr>
<td>The listed entity through its Board of directors shall constitute the nomination and remuneration committee which shall comprise at least 3 directors, all of whom shall be non executive directors and at least ½ shall be independent.</td>
</tr>
<tr>
<td>Chairperson of the committee shall be an independent director. The chairperson of the listed entity (whether executive or non-executive) may be appointed as a member of the nomination and remuneration committee but shall not chair such committee.</td>
</tr>
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<td>The role of the committee shall, inter alia, include the following:</td>
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<td>2. Formulation of criteria for evaluation of Independent Directors and the Board;</td>
</tr>
<tr>
<td>3. Devising a policy on Board diversity;</td>
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</table>
their appointment and removal, specify the manner for effective evaluation of performance of Board, its committees and individual directors to be carried out either by the Board, by the Nomination and Remuneration Committee or by an independent external agency and review its implementation and compliance.

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

The nomination and remuneration committee shall while formulating the policy ensure that—

a) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully;

b) relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and

c) remuneration to directors, KMPs and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals:

The policy shall be placed on the website of the company, if any, and

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 listed entity shall disclose the remuneration policy and the evaluation criteria in its annual report.

The quorum for a meeting of the nomination and remuneration committee shall be either two members or one third of the members of the committee, whichever is greater, including at least one independent director in attendance. The Nomination and Remuneration Committee shall meet at least once in a year.

The Chairperson of the nomination and remuneration committee may be present at the AGM, to answer the shareholders’ queries.

However, it would be up to the Chairperson to decide who should answer the queries.
<table>
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<tr>
<th>18. Risk management</th>
<th><strong>Section 134(3)(n)</strong></th>
<th><strong>Regulation21</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The Board's report required to include a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, this in the opinion of the Board may threaten the existence of the company.</td>
<td>The top 100 listed entities, determined on the basis of market capitalization, as at the end of the immediate previous financial year, shall lay down procedures to inform Board members about the risk assessment and minimization procedures. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the listed entity. The listed entity through its Board of Director shall constitute a Risk Management Committee. The majority of Committee shall consist of members of the Board of Directors. The Board shall define the roles and responsibility of the risk management committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit. Senior executives of the listed entity may be members of the said committee but the Chairperson of the committee shall be a member of the Board of Directors. The risk management committee shall meet at least once in a year.</td>
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<thead>
<tr>
<th>18. Related Party</th>
<th><strong>Section 2(76)</strong></th>
<th><strong>Clause 2(zb)</strong></th>
</tr>
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<tbody>
<tr>
<td>“Related party”, with reference to a company, means—</td>
<td></td>
<td>For the purpose of listing regulation, an entity shall be considered as related to the listed entity if:</td>
</tr>
<tr>
<td>(i) a director or his relative</td>
<td></td>
<td>Such entity is a related party under Section 2(76) of the Companies Act, 2013; or</td>
</tr>
<tr>
<td>(ii) a Key Managerial Personnel or his relative;</td>
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<td></td>
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</table>
(iii) a firm, in which a director, manager or his relative is a partner;
(iv) a private company in which a director or manager or his relative is a member or director;
(v) a public company in which a director or manager is a director and holds along with his relatives, more than 2% of its paid-up share capital;
(vi) anybody corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;
(vii) any person on whose advice, directions or instructions a director or manager is accustomed to act;
(viii) any body corporate which is—
   A. a holding, subsidiary or an associate company of such company;
   B. a subsidiary of a holding company to which it is also a subsidiary; or
   C. an investing company or the venturer of the company.
(ix) such other person as may be prescribed.

Rule 3 of the Companies (Specification of Definitions Details) Rules, 2014 provides that a director or key managerial personnel of the holding company or his relative with reference to a company shall be deemed to be a related party.

Such entity is a related party under the applicable accounting standards.
Provided that any person or entity belonging to the promoter or promoter group of the listed entity and holding 20% or more of the shareholding in the listed entity shall be deemed to be a related party.

20. Disclosure of Related Party

Section 134(3)(h) read with Rule 8 of Companies (Accounts) Rules, 2014

Regulation 27, 46 & 53

Details of all material transactions
<table>
<thead>
<tr>
<th>Transactions</th>
<th>Board's Report shall contain particulars of contracts or arrangements with related party as referred in Section 188(1) of the Companies Act, 2013 in the Form AOC-2.</th>
<th>with related parties shall be disclosed quarterly along with the compliance report on corporate governance. The listed entity shall disclose the policy on dealing with Related Party Transactions under a separate section on its website and a web link thereto shall be provided in the Annual Report.</th>
</tr>
</thead>
<tbody>
<tr>
<td>21. Disclosure of different Accounting standard</td>
<td>Section 129(5) Where the financial statements of a company do not comply with the accounting standards, the company shall disclose in its financial statements, the deviation from the accounting standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation.</td>
<td>Regulation34(3) read with Schedule V Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management’s explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction in the Corporate Governance Report.</td>
</tr>
<tr>
<td>22. Disclosure on Remuneration</td>
<td>Section 197 and Rule 5 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 (1) Every listed company shall disclose in the Board’s report: i. The ratio of the remuneration of each director to the median remuneration of the employees of the company for the financial year. ii. the percentage increase in remuneration of each director, CFO, CEO, CS or Manager, if any, in the financial year; iii. the percentage increase in the median remuneration of employees in the financial year; iv. the number of permanent employees on the rolls of company;</td>
<td>Regulations 26,34(3) read with Schedule V 1. All pecuniary relationship or transactions of the non-executive directors vis-à-vis the listed entity shall be disclosed in the Annual Report. 2. In addition to the disclosures required under the Companies Act, 2013, the following disclosures on the remuneration of directors shall be made in the section on the corporate governance of the Annual Report: a. All elements of remuneration package of individual directors summarized under major groups, such as salary, benefits, bonuses, stock options, pension etc. b. Details of fixed component</td>
</tr>
</tbody>
</table>
v. average percentile increase already made in the salaries of employees other than the managerial personnel in the last financial year and its comparison with the percentile increase in the managerial remuneration and justification thereof and point out if there are any exceptional circumstances for increase in the managerial remuneration;

vi. Affirmation that the remuneration is as per the remuneration policy of the company.

3. The listed entity shall publish its criteria of making payments to non-executive directors in its annual report. Alternatively, this may be put up on the listed entity website and reference drawn thereto in the annual report.

4. The listed entity shall disclose the number of shares and convertible instruments held by non-executive directors in the annual report.

5. Non-executive directors shall be required to disclose their shareholding (both own or held by / for other persons on a beneficial basis) in the listed entity in which they are proposed to be appointed as directors, prior to their appointment.

These details should be disclosed in the notice to the general meeting called for appointment of such director.

23. Stakeholders Relationship Committee

Section 178(5)&(6)

The Board of Directors of a company which consists of more than one thousand shareholders, debenture-holders, deposit holders and any other security holders at any time during a financial year shall constitute a Stakeholders Relationship Committee consisting of a chairperson who shall be a non-

Regulation 20

A committee under the Chairperson of a non-executive director and such other members as may be decided by the Board of the listed entity shall be formed to specifically look into the various aspects of interest of shareholders, debenture holders and other security holders.
executive director and such other members as may be decided by the Board.

The Stakeholders Relationship Committee shall consider and resolve the grievances of security holders of the company.

This Committee shall consider and resolve the grievances of the security holders of the listed entity including complaints related to transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends.

CORPORATE POLICIES

The management of a company typically involves three tiers of documentation addressing operational issues. Memorandum of association creates the entity in the first place. Articles of association provide structural definition to the enterprise. Policies and procedures delineate more specific processes for day-to-day operations.

Policies are an essential component of every organisation and address important issues. Utilizing policies during decision-making ensures that the management is consistent in its decisions. These policies must be effectively communicated amongst stakeholders. The company should provide easy access to policies and also publicly disclose. These policies serve as important forms of internal control, it minimize cost and help in building a learning culture.

A Company has to formulate specific policies in different areas of operations that help to bring uniformity in processes by clearly defining the business approach. Some of the policies are legally required, some are organisational needs and some are voluntarily made as part of good governance. The policies which are mandatorily required to be formulated under the Companies Act, 2013 are as under:

1. Risk management policy
2. Corporate social responsibility Policy
3. Nomination and remuneration Policy

A listed company has to formulate following policies as per the requirements of SEBI (LODR) Regulations:

1. Policy for preservation of documents
2. Policy for determining 'material' subsidiary
3. Policy on related party transactions
4. Policy for determination of materiality
5. Archival policy
6. Dividend distribution policy
7. Whistle blower policy
8. Policy on diversity of board of directors
9. Familiarization Programme for Independent Directors

A listed company has to also formulate Insider Trading Policy as per the requirements of SEBI (Prohibition of Insider Trading) Regulations, 2015.
There are some policies which are mandated in other laws, and include:

1. Policy for prevention of sexual harassment at workplace

In addition to above, the companies may also formulate following policies:

1. Code of business conduct & Ethics
2. Ethics policy
3. Information security policy
4. Health and safety policy
5. Gender diversity policy
6. Environmental policy
7. Policy on investor relations
8. Quality policy
9. Social accountability policy
10. Communication policy
11. Investment and cash policy
12. Policy for ascertaining the ‘Fit and Proper’ status of directors
13. Affirmative action policy
14. Code of corporate disclosures

The Indian legislative requirements demands corporate to develop various policies/codes and also disclose them properly.

**DISCLOSURE AND TRANSPARENCY REQUIREMENTS UNDER COMPANIES ACT 2013 AND SEBI REGULATIONS**

1. **IN TERMS OF COMPANIES ACT, 2013**

In terms of Companies Act, 2013 the aspect of disclosure and transparency spans over several sections.

A. **Disclosures under Section 134 of Companies Act 2013**

Section 134(3) provides that there shall be attached to statements laid before a company in general meeting, a report by its Board of Directors, which shall include—

(a) the web address, if any, where annual return referred to in sub-section (3) of section 92 has been placed.

(b) number of meetings of the Board.

(c) Directors’ Responsibility Statement.

(ca) details in respect of frauds reported by auditors under sub-section (12) of section 143 other than those which are reportable to the Central Government.
(d) a statement on declaration given by independent directors under section 149(6).

(e) in case of a company covered under sub-section (1) of section 178, company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters as given under sub-section (3) of section 178.

(f) explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made—
   (i) by the auditor in his report; and
   (ii) by the company secretary in practice in his secretarial audit report.

(g) particulars of loans, guarantees or investments under section 186.

(h) particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the prescribed form.

(i) the state of the company's affairs.

(j) the amounts, if any, which it proposes to carry to any reserves.

(k) the amount, if any, which it recommends should be paid by way of dividend.

(l) material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report.

(m) the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed.

(n) a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company.

(o) the details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year.

(p) 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 of the performance of the Board, its Committees and of individual directors has been made.

(q) such other matters as may be prescribed.

Provided that where disclosures referred to in this sub-section have been included in the financial statements, such disclosures shall be referred to instead of being repeated in the Board's report.

Provided further that where the policy referred to in clause (e) or clause (o) is made available on company's website, if any, it shall be sufficient compliance of the requirements under such clauses if the salient features of the policy and any change therein are specified in brief in the Board's report and the web-address is indicated therein at which the complete policy is available.

In case of a Government company, clause (e) is not applicable and in case the directors are evaluated by the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government, as per its own evaluation methodology, clause (p) is not applicable.

As per Section 134(5), the Directors' Responsibility Statement referred to in clause (c) of sub-section (3) shall state that—

(a) in the preparation of the annual accounts, the applicable accounting standards had been followed
along with proper explanation relating to material departures;

(b) the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period;

(c) the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;

(d) the directors had prepared the annual accounts on a going concern basis;

(e) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.

Explanation to clause(e) defines the term “internal financial controls as the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information; and

(f) the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.

B. Disclosures under other Sections of Companies Act, 2013

Section 178(4) states that the Board’s Report shall include a policy formulated by Nomination and Remuneration Committee. The policy shall ensure that:

(a) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully;

(b) relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and

(c) Remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals.

As per section 149(10) an independent director shall be eligible for reappointment on passing of a special resolution and the Board’s Report shall disclose such appointment.

Under section 177(8), Board’s Report shall disclose the composition of audit committee and shall also disclose the recommendation of the audit committee which is not accepted by the board along with reasons thereof.

Proviso to section 177(10) prescribes the inclusion of the details of establishment of vigil mechanism under section 177(9) in the Board’s Report.

With the e-filing of forms with the Registrar of Companies, The Ministry of Corporate Affairs has put in place a mechanism that is imaginative, technologically savvy and stakeholder friendly. Through the application of Information Technology to the Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) Governance, the MCA aims at moving from paper based to nearly paperless environment.
As per section 204(1) every listed company and other prescribed companies in Rule 9 Companies (Appointment & Remuneration of Managerial Personnel) Rules, 2014 shall annex the secretarial audit report given by a Company Secretary in practice with Board’s Report. Board in its report shall explain any qualification or observation or other remarks made by the Company Secretary in Practice.

Section 135(2) provides that the Board’s report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee.

Section 134(8) states that 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 lakhs rupees. 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 lakhs rupees, or with both.

2. IN TERMS OF VARIOUS RULES MADE UNDER COMPANIES ACT, 2013

A. Companies (Accounts) Rules 2014

As per Rule 8 of Companies (Accounts) Rules 2014 following matters to be disclose in the Board’s Report:

(1) The Board’s Report shall be prepared based on the stand alone financial statements of the company and shall report on the highlights of performance of subsidiaries, associates and joint venture companies and their contribution to the overall performance of the company during the period under report.

(2) The Report of the Board shall contain the particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the Form AOC-2.

(3) The report of the Board shall contain the following information and details, namely:

(A) Conservation of energy- the capital investment on energy conservation equipments, The steps taken the steps taken for conservation of energy and utilising alternate sources of energy and the impact thereon

(B) Technology absorption- the efforts made towards technology absorption, expenditure incurred on R&D, the benefits derived, in case of imported technology; the details about year of import, absorption of technology imported.

(C) Foreign exchange earnings and outgo- actual inflows and outgo during the year.

The requirement of furnishing information and details under this sub-rule shall not apply to a government company engaged in producing defence equipment.

(4) Every listed company and every other public company having a paid up share capital of twenty five crore rupees or more calculated at the end of the preceding financial year shall 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.

(5) In addition to the information and details specified in sub-rule (4), the report of the Board shall also contain –

(i) the financial summary or highlights;

(ii) the change in the nature of business, if any;

(iii) the details of directors or key managerial personnel who were appointed or have resigned during
(iv) the names of companies which have become or ceased to be its Subsidiaries, joint ventures or associate companies during the year;

(v) the details relating to deposits, covered under Chapter V of the Act

(vi) the details relating to deposits, not in compliance with Chapter V of the Act.

(vii) the details of significant and material orders passed by the regulators or courts or tribunals impacting the going concern status and company’s operations in future.

(viii) the details in respect of adequacy of internal financial controls with reference to the Financial Statements.

B. Companies (Share Capital and Debenture) Rules, 2014

The Board of Directors shall, inter alia, disclose details regarding issue of shares with differential rights in the Board’s Report for the financial year in which the issue of equity shares with differential rights was completed.

As per sub rule (13) of rule 8 the Board of Directors shall, inter alia, disclose details about the issue of sweat equity shares in the Directors’ Report for the year in which such shares are issued.

As per the rule 12(9) of Companies (Share Capital and Debenture) Rules 2014, the Board of directors, shall, inter alia, disclose details of the Employees Stock Option Scheme in the Directors’ Report for the year.

When the voting rights are not exercised directly by the employees in respect of shares to which the scheme relates, the Board of Directors shall, inter alia, disclose in the Board’s report for the relevant financial year, Disclosures shall be made in terms of Rule 16(4) Companies (Share Capital and Debentures) Rules, 2014.

C. Companies (Appointment & Remuneration of Managerial Personnel) Rules, 2014

Rule 5(1) of Companies (Appointment & Remuneration of Managerial Personnel) Rules, 2014 made under Chapter IV provides the following disclosure by the listed companies in the Board’s Report:-

(i) the ratio of the remuneration of each director to the median remuneration of the employees of the company for the financial year;

(ii) the percentage increase in remuneration of each director, Chief Financial Officer, Chief Executive Officer, Company Secretary or Manager, if any, in the financial year;

(iii) the percentage increase in the median remuneration of employees in the financial year;

(iv) the number of permanent employees on the rolls of company;

(v) average percentile increase already made in the salaries of employees other than the managerial personnel in the last financial year and its comparison with the percentile increase in the managerial remuneration and justification thereof and point out if there are any exceptional circumstances for increase in the managerial remuneration;

(vi) affirmation that the remuneration is as per the remuneration policy of the company.

For the purposes of this rule.- (i) the expression “median” means the numerical value separating the higher half of a population from the lower half and the median of a finite list of numbers may be found by arranging all the observations from lowest value to highest value and picking the middle one.

Rule 5(2) prescribes that the board’s report shall include a statement showing the name of the top ten
employees in terms of remuneration drawn and the name of every employee, who-

(i) if employed throughout the financial year, was in receipt of remuneration for that year which, in the aggregate, was not less than one crore and two lakh rupees;

(ii) if employed for a part of the financial year, was in receipt of remuneration for any part of that year, at a rate which, in the aggregate, was not less than eight lakh and fifty thousand rupees per month;

(iii) if employed throughout the financial year or part thereof, was in receipt of remuneration in that year which, in the aggregate, or as the case may be, at a rate which, in the aggregate, is in excess of that drawn by the managing director or whole-time director or manager and holds by himself or along with his spouse and dependent children, not less than two percent of the equity shares of the company.

(3) The statement referred to in sub-rule (2) shall also indicate -

(i) designation of the employee;

(ii) remuneration received;

(iii) nature of employment, whether contractual or otherwise;

(iv) qualifications and experience of the employee;

(v) date of commencement of employment;

(vi) the age of such employee;

(vii) the last employment held by such employee before joining the company;

(viii) the percentage of equity shares held by the employee in the company within the meaning of clause (iii) of sub-rule (2) above; and

(ix) whether any such employee is a relative of any director or manager of the company and if so, name of such director or manager.

Proviso (i) says that the particulars of employees posted and working in a country outside India, not being directors or their relatives, drawing more than sixty lakh rupees per financial year or five lakh rupees per month, as the case may be, as may be decided by the Board, shall not be circulated to the members in the Board’s report, but such particulars shall be filed with the Registrar of Companies while filing the financial statement and Board Reports:

Proviso (ii) says that such particulars shall be made available to any shareholder on a specific request made by him in writing before the date of such Annual General Meeting wherein financial statements for the relevant financial year are proposed to be adopted by shareholders and such particulars shall be made available by the company within three days from the date of receipt of such request from shareholders:

Proviso (iii) says that in case of request received even after the date of completion of Annual General Meeting, such particulars shall be made available to the shareholders within seven days from the date of receipt of such request.

D. Companies (Corporate Social Responsibility) Rules, 2014

Rule 8 of the Companies (Corporate Social Responsibility) Rules, 2014 prescribes that the following CSR
reporting:-

(i) The Board’s Report of a company under these rules pertaining to a financial year commencing on a or after 1st day of April, 2014 shall include an Annual Report on CSR containing particulars specified in Annexure.

(ii) In case of a foreign company, the balance sheet filed under section 381(1)(a) shall contain an Annexure regarding report on CSR.

3. DISCLOSURES IN TERMS OF SEBI REGULATIONS

A. SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

Filing of offer document (Regulation 6)

No issuer shall make,

(a) a public issue; or

(b) A right issue, where the aggregate value of the specified securities offered is fifty lakh rupees or more,

Unless a draft offer document, along with fees as specified in Schedule IV, has been filed with the SEBI through the lead merchant banker, at least thirty days prior to registering the prospectus, red herring prospectus or shelf prospectus with the Registrar of Companies or filing the letter of offer with the designated stock exchange, as the case may be.

Copies of offer documents to be available to public (Regulation 61)

1. The issuer and lead merchant bankers shall ensure that the contents of offer documents hosted on the websites as required in these regulations are the same as that of their printed versions as filed with the Registrar of Companies, SEBI and the stock exchanges.

2. The lead merchant bankers and the recognised stock exchange shall provide copies of the draft offer document and final offer document to the public as and when requested.

3. The lead merchant bankers or the recognised stock exchange may charge a reasonable sum for providing the copy of the offer document.

Manner of disclosures in the offer document (Regulation 57)

1. The offer document shall contain all material disclosures which are true and adequate so as to enable the applicants to take an informed investment decision.

2. Without prejudice to the generality of sub-regulation (1):

   (a) the red-herring prospectus, shelf prospectus and prospectus shall contain:

      (i) the disclosures specified in section 26 of the Companies Act, 2013; and

      (ii) the disclosures specified in the Schedule attached to the Regulations.

   (b) the letter of offer shall contain disclosures as specified in the Schedule attached to the Regulations.

Provided that in the case of a further public offer or a rights issue, the offer document shall be deemed to be in compliance with the provisions of this regulation, if suitable references are made to the updated
disclosures in the offer document referred to in regulation 51A of these regulations.

**Pre-issue advertisement for public issue (Regulation 47)**

1. Subject to the provisions of section 30 of the Companies Act, 2013, the issuer shall, after registering the red herring prospectus (in case of a book built issue) or prospectus (in case of fixed price issue) with the Registrar of Companies, make a pre- issue advertisement in one English national daily newspaper with wide circulation, Hindi national daily newspaper with wide circulation and one regional language newspaper with wide circulation at the place where the registered office of the issuer is situated.

2. The pre-issue advertisement shall be in the format and shall contain the disclosures specified in the schedule attached to the regulations.

**Issue opening and issue closing advertisement for public issue (Regulation 48)**

An issuer may issue advertisements for issue opening and issue closing in the formats specified in Schedule XIII of the regulations.

**Post-issue reports (Regulation 65)**

(1) In public issue, the lead merchant banker shall submit final post-issue report as specified in Part C of Schedule XVI, within seven days of the date of finalization of basis of allotment or within seven days of refund of money in case of failure of issue.

(2) In rights issue, the lead merchant banker shall submit post-issue reports as follows:-

   a. initial post issue report as specified in Part B of Schedule XVI, within three days of closure of the issue;

   b. final post issue report as specified in Part D of Schedule XVI, within fifteen days of the date of finalization of basis of allotment or within fifteen days of refund of money in case of failure of issue.

The lead merchant banker shall submit a due diligence certificate as per the format specified, along with the final post issue report.

**Post-issue Advertisements (Regulation 66)**

1. The post-issue merchant banker shall ensure that advertisement giving details relating to oversubscription, basis of allotment, number, value and percentage of all applications including ASBA (Application Supported by Blocked Amount) number, value and percentage of successful allottees for all applications, date of completion of dispatch of refund orders or instructions to Self Certified Syndicate Banks by the Registrar, date of dispatch of certificates and date of filing of listing application, etc. is released within ten days from the date of completion of the various activities in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where registered office of the issuer is situated.

2. The post-issue merchant banker shall ensure that issuer, advisors, brokers or any other entity connected with the issue shall not publish any advertisement stating that issue has been oversubscribed or indicating investors’ response to the issue, during the period when the public issue is still open for subscription by the public.

**Other Responsibilities (Regulation 69(4))**

The issuer shall ensure that transactions in securities by the promoter and promoter group during the period between the date of registering the offer document with the Registrar of Companies or filing the letter of offer
with the designated stock exchange, as the case may be and the date of closure of the issue shall be reported to the recognised stock exchanges where the specified securities of the issuer are listed, within twenty four hours of the transactions.

B.SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011

Upon receipt of the disclosures required under this Chapter, the stock exchange shall forthwith disseminate the information so received.

Disclosure of acquisition and disposal (Regulation 29)

1. Any acquirer who acquires shares or voting rights in a target company (together with person acting in concert with him), aggregating to five per cent or more of the shares of such target company, shall disclose their aggregate shareholding and voting rights in such target company in specified format.

2. Further, any person, who together with persons acting in concert with him, holds shares or voting rights entitling them to five per cent or more of the shares or voting rights in a target company, shall disclose the number of shares or voting rights held and subsequent change in shareholding or voting rights, even if such change results in shareholding falling below five per cent and such change exceeds two per cent of total shareholding or voting rights in the target company, in the prescribed format.

The disclosures required under sub-regulation (1) and (2) shall be made within two working days of the receipt of intimation of allotment of shares, or the acquisition of shares or voting rights in the target company to,—

(a) every stock exchange where the shares of the target company are listed; and

(b) the target company at its registered office.

For the purposes of aforesaid, shares taken by way of encumbrance shall be treated as an acquisition, shares given upon release of encumbrance shall be treated as a disposal, and disclosures shall be made by such person accordingly.

However, this requirement shall not apply to a scheduled commercial bank or public financial institution as pledgee in connection with a pledge of shares for securing indebtedness in the ordinary course of business.

Continual disclosures (Regulation 30)

1. Every person, who together with persons acting in concert with him, holds shares or voting rights entitling him to exercise twenty-five per cent or more of the voting rights in a target company, shall disclose their aggregate shareholding and voting rights as of the thirty-first day of March, in such target company in the prescribed format.

2. The promoter of every target company shall together with persons acting in concert with him, disclose their aggregate shareholding and voting rights as of the thirty-first day of March, in such target company in such form as may be specified.

The disclosures required under sub-regulation (1) and (2) shall be made within seven working days from the end of each financial year to,—

(a) every stock exchange where the shares of the target company are listed; and

(b) the target company at its registered office.

Disclosure of encumbered shares (Regulation 31)

1. The promoter of every target company shall disclose details of shares in such target company
encumbered by him or by persons acting in concert with him in the prescribed format.

2. The promoter of every target company shall disclose details of any invocation of such encumbrance or release of such encumbrance of shares in prescribed format.

3. The disclosures required under sub-regulation (1) and sub-regulation (2) shall be made within seven working days from the creation or invocation or release of encumbrance, as the case may be to,—
   (a) every stock exchange where the shares of the target company are listed; and
   (b) the target company at its registered office.

C. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

Under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, there are certain intimations and disclosures which are required to be made to the stock exchanges for the timely and accurate dissemination of the information to all the stakeholders. The listed entities which have listed its specified securities on any recognised stock exchange(s) either on the main board or on SME Exchange or on institutional trading platform are required to make following intimations and disclosures.

PRIOR INTIMATIONS (REGULATION 29)

The listed entity shall give prior intimation to stock exchange about the meeting of the board of directors in
the following manner-

A. At least two working days in advance, excluding the date of the intimation and date of the meeting in which any of the following proposals is due to be considered-

- proposal for buyback of securities;
- proposal for voluntary delisting by the listed entity from the stock exchange(s);
- fund raising by way of further public offer, rights issue, American Depository Receipts/Global Depository Receipts/Foreign Currency Convertible Bonds, qualified institutions placement, debt issue, preferential issue or any other method and for determination of issue price. Provided that intimation shall also be given in case of any annual general meeting or extraordinary general meeting or postal ballot that is proposed to be held for obtaining shareholder approval for further fund raising indicating type of issuance
- declaration/recommendation of dividend, issue of convertible securities including convertible debentures or of debentures carrying a right to subscribe to equity shares or the passing over of dividend.
- the proposal for declaration of bonus securities where such proposal is communicated to the board of directors of the listed entity as part of the agenda papers.

B. At least five days in advance excluding the date of the intimation and date of the meeting in which following proposal is due to be considered-,

- financial results viz. quarterly, half yearly, or annual, as the case may be; (the intimation shall include the date of such meeting of board of directors also)

C. At least eleven working days before any of the following proposal is placed before the board of directors -

- any alteration in the form or nature of any of its securities that are listed on the stock exchange or in the rights or privileges of the holders thereof.
- any alteration in the date on which, the interest on debentures or bonds, or the redemption amount of redeemable shares or of debentures or bonds, shall be payable.

4. DISCLOSURE OF EVENTS OR INFORMATION [REGULATION (30)]

A. Disclosure of Material Events-

Regulation 30(1) and (2) of the Listing Regulations specifies that every listed entity shall make disclosures upon occurrence of following events or information which are deemed to be material events as per Part ‘A’ of Schedule III. These events or information should be disclosed as soon as reasonably possible and not later than 24 hours from the occurrence of event or information. In case the disclosure is made after 24 hours of occurrence of the event or information, the listed entity shall, along with such disclosures provide explanation for delay.

(i) Acquisition(s) (including agreement to acquire), Scheme of Arrangement (amalgamation/ merger/ demerger/restructuring), or sale or disposal of any unit(s), division(s) or subsidiary of the listed entity or any other restructuring

(ii) Issuance or forfeiture of securities, split or consolidation of shares, buyback of securities, any restriction on transferability of securities or alteration in terms or structure of existing securities
including forfeiture, reissue of forfeited securities, alteration of calls, redemption of securities etc.

(iii) Revision in Rating(s)

(iv) Agreements (viz. shareholder agreement(s), joint venture agreement(s), family settlement agreement(s) (to the extent that it impacts management and control of the listed entity), agreement(s)/treaty(ies)/contract(s) with media companies) which are binding and not in normal course of business, revision(s) or amendment(s) and termination(s) thereof.

(v) Fraud/defaults by promoter or key managerial personnel or by listed entity or arrest of key managerial personnel or promoter.

(vi) Change in directors, key managerial personnel (Managing Director, Chief Executive Officer, Chief Financial Officer, Company Secretary etc.), Auditor and Compliance Officer.

(vii) Appointment or discontinuation of share transfer agent.

(viii) Corporate debt restructuring.

(ix) One time settlement with a bank.

(x) Reference to BIFR and winding-up petition filed by any party / creditors.

(xi) Issuance of Notices, call letters, resolutions and circulars sent to shareholders, debenture holders or creditors or any class of them or advertised in the media by the listed entity.

(xii) Proceedings of Annual and extraordinary general meetings of the listed entity.

(xiii) Amendments to memorandum and articles of association of listed entity, in brief.

(xiv) Schedule of Analyst or institutional investor meet and presentations on financial results made by the listed entity to analysts or institutional investors.

The listed entity shall disclose to the Exchange(s), outcome of Meetings of the board of directors within 30 minutes of the closure of the meeting, held to consider the following:

(i) dividends and/or cash bonuses recommended or declared or the decision to pass any dividend and the date on which dividend shall be paid/dispatched;

(ii) any cancellation of dividend with reasons thereof;

(iii) the decision on buyback of securities;

(iv) the decision with respect to fund raising proposed to be undertaken

(iv) increase in capital by issue of bonus shares through capitalization including the date on which such bonus shares shall be credited/dispatched;

(vi) reissue of forfeited shares or securities, or the issue of shares or securities held in reserve for future issue or the creation in any form or manner of new shares or securities or any other rights, privileges or benefits to subscribe to;

(vii) short particulars of any other alterations of capital, including calls;

(viii) financial results

(ix) decision on voluntary delisting by the listed entity from stock exchange(s).
B. Disclosures of events upon application of the Materiality Guidelines

Regulation 30(3) of the Listing Regulations specifies that the listed entity shall make disclosure of events specified in Part ‘A’ of Schedule III, based on application of the guidelines for materiality.

The board of directors of the listed entity shall authorize one or more Key Managerial Personnel for the purpose of determining materiality of an event or information and for the purpose of making disclosures to stock exchange(s) under this regulation and the contact details of such personnel shall be also disclosed to the stock exchange(s) and as well as on the listed entity's website.

What are the Materiality Guidelines?

As per Regulation (4), the listed entity shall frame a policy for determination of materiality of events/information, approved by the board of directors and which shall be disclosed on its website on the basis of following criteria-

a) the omission of an event or information, which is likely to result in discontinuity or alteration of event or information already available publicly; or

b) the omission of an event or information is likely to result in significant market reaction if the said omission came to light at a later date; or

c) an event/information may be treated as being material if in the opinion of the board of directors of listed entity, the event/information is considered material.

Following events shall be disclosed upon application of the guidelines for materiality. These events or information should be disclosed as soon as reasonably possible and not later than 24 hours from the occurrence of event or information. In case the disclosure is made after 24 hours of occurrence of the event or information, the listed entity shall, along with such disclosures provide explanation for delay.

1. Commencement or any postponement in the date of commencement of commercial production or commercial operations of any unit/division.

2. Change in the general character or nature of business brought about by arrangements for strategic, technical, manufacturing, or marketing tie-up, adoption of new lines of business or closure of operations of any unit/division (entirety or piecemeal).

3. Capacity addition or product launch.

4. Awarding, bagging/receiving, amendment or termination of awarded/bagged orders/contracts not in the normal course of business.

5. Agreements (viz. loan agreement(s) (as a borrower) or any other agreement(s) which are binding and not in normal course of business) and revision(s) or amendment(s) or termination(s) thereof.

6. Disruption of operations of any one or more units or division of the listed entity due to natural calamity (earthquake, flood, fire etc.), force majeure or events such as strikes, lockouts etc.

7. Effect(s) arising out of change in the regulatory framework applicable to the listed entity

8. Litigation(s) / dispute(s) / regulatory action(s) with impact.

9. Fraud/defaults etc. by directors (other than key managerial personnel) or employees of listed entity.

10. Options to purchase securities including any ESOP/ESPS Scheme.

11. Giving of guarantees or indemnity or becoming a surety for any third party.

12. Granting, withdrawal, surrender, cancellation or suspension of key licenses or regulatory approvals.
C. Disclosure of Other Events

Any other information/event viz. major development that is likely to affect business, e.g. emergence of new technologies, expiry of patents, any change of accounting policy that may have a significant impact on the accounts, etc. and brief details thereof and any other information which is exclusively known to the listed entity which may be necessary to enable the holders of securities of the listed entity to appraise its position and to avoid the establishment of a false market in such securities must be disclosed. (Para C, Part ‘A’ of Schedule III)

5. DISCLOSURES OF FINANCIAL RESULTS [Regulation (33)]

The listed entity shall make the following disclosures while preparing the financial results as specified in Part A of Schedule IV.

A. Changes in accounting policies, if any, shall be disclosed in accordance with Accounting Standard 5 or Indian Accounting Standard 8, as applicable, specified in Section 133 of the Companies Act, 2013 read with relevant rules framed thereunder or by the Institute of Chartered Accountants of India, whichever is applicable.

B. If the auditor has expressed any modified opinion(s) in respect of audited financial results submitted or published under this para, the listed entity shall disclose such modified opinion(s) and cumulative impact of the same on profit or loss, net worth, total assets, turnover/total income, earning per share, total expenditure, total liabilities, any other financial item(s) which may be impacted due to modified opinion(s), while publishing or submitting such results.

BA. If the auditor has expressed any modified opinion(s), the management of the listed entity has the option to explain its views on the audit qualifications and the same shall be included in the Statement on Impact of Audit Qualifications (for audit report with modified opinion).

BB. With respect to audit qualifications where the impact of the qualification is not quantifiable:

i. The management shall make an estimate and the auditor shall review the same and report accordingly; or

ii. If the management is unable to make an estimate, it shall provide the reasons and the auditor shall review the same and report accordingly.

The above shall be included in the statement on impact of audit qualifications (for audit report with modified opinion).

C. If the auditor has expressed any modified opinion(s) or other reservation(s) in his audit report or limited review report in respect of the financial results of any previous financial year or quarter which has an impact on the profit or loss of the reportable period, the listed entity shall include as a note to the financial results –

(i) how the modified opinion(s) or other reservation(s) has been resolved; or

(ii) if the same has not been resolved, the reason thereof and the steps which the listed entity intends to take in the matter.

D. If the listed entity has changed its name suggesting any new line of business, it shall disclose the net sales or income, expenditure and net profit or loss after tax figures pertaining to the said new line of business separately in the financial results and shall continue to make such disclosures for the three years succeeding the date of change in name: Provided that the tax expense shall be allocated between the said new line of business and other business of the listed entity in the ratio of
the respective figures of net profit before tax, subject to any exemption, deduction or concession available under the tax laws.

E. If the listed entity had not commenced commercial production or commercial operations during the reportable period, the listed entity shall, instead of submitting financial results, disclose the following details:

(i) details of amount raised i.e. proceeds of any issue of shares or debentures made by the listed entity;

(ii) the portions thereof which is utilized and that remaining unutilized;

(iii) the details of investment made pending utilisation;

(iv) brief description of the project which is pending completion;

(v) status of the project; and

(vi) expected date of commencement of commercial production or commercial operations:

Provided that the details mentioned above shall be approved by the board of directors based on certification by the chief executive officer and chief financial officer.

F. All items of income and expenditure arising out of transactions of exceptional nature shall be disclosed.

G. Extraordinary items, if applicable, shall be disclosed in accordance with Accounting Standard 5 (AS 5 – Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies) or Companies (Accounting Standards) Rules, 2006, whichever is applicable.

H. The listed entity, whose revenues are subject to material seasonal variations, shall disclose the seasonal nature of their activities and the listed entity may supplement their financial results with information for the twelve month period ending on the last day of the quarter for the current and preceding years on a rolling basis.

I. The listed entity shall disclose any event or transaction which occurred during or before the quarter that is material to an understanding of the results for the quarter including but not limited to completion of expansion and diversification programmes, strikes and lock-outs, change in management, change in capital structure and the listed entity shall also disclose similar material events or transactions that take place subsequent to the end of the quarter.

J. The listed entity shall disclose the following in respect of dividends paid or recommended for the year, including interim dividends:

- amount of dividend distributed or proposed for distribution per share; the amounts in respect of different classes of shares shall be distinguished and the nominal values of shares shall also be indicated;

- where dividend is paid or proposed to be paid pro-rata for shares allotted during the year, the date of allotment and number of shares allotted, pro-rata amount of dividend per share and the aggregate amount of dividend paid or proposed to be paid on pro-rata basis.

K. The listed entity shall disclose the effect on the financial results of material changes in the composition of the listed entity, if any, including but not limited to business combinations, acquisitions or disposal of subsidiaries and long term investments, any other form of restructuring and discontinuance of operations.
L. The listed entity shall ensure that segment reporting is done in accordance with AS-17 or Indian Accounting Standard 108 as applicable, specified in Section 133 of the Companies Act, 2013 read with relevant rules framed thereunder or by the Institute of Chartered Accountants of India, whichever is applicable.

6. ANNUAL REPORT DISCLOSURES [REGULATION (34)]

The listed entity shall submit the annual report to the stock exchange within twenty one working days of it being approved and adopted in the annual general meeting as per the provisions of the Companies Act, 2013 which shall contain the following:

- audited financial statements i.e. balance sheets, profit and loss accounts etc, and Statement on Impact of Audit Qualifications as stipulated in regulation 33(3)(d), if applicable;
- consolidated financial statements audited by its statutory auditors;
- cash flow statement presented only under the indirect method as prescribed in Accounting Standard-3 or Indian Accounting Standard 7, as applicable, specified in Section 133 of the Companies Act, 2013 read with relevant rules framed thereunder or as specified by the Institute of Chartered Accountants of India, whichever is applicable;
- directors report;
- management discussion and analysis report - either as a part of directors report or addition thereto;
- Business Responsibility Reports.
Additional Disclosures in Annual Report

The annual report shall contain any other disclosures specified in Companies Act, 2013 along following additional disclosures as specified in Schedule V.

A. Related Party Disclosure:

1. The listed entity shall make disclosures in compliance with the Accounting Standard on “Related Party Disclosures”.

2. The disclosure requirements shall be as follows:

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>In the accounts of</th>
<th>Disclosures of amounts at the year end and the maximum amount of loans/ advances/ Investments outstanding during the year.</th>
</tr>
</thead>
</table>
| 1       | Holding Company          | • Loans and advances in the nature of loans to subsidiaries by name and amount.  
|         |                          | • Loans and advances in the nature of loans to associates by name and amount.  
|         |                          | • Loans and advances in the nature of loans to firms/companies in which directors are interested by name and amount.  |
| 2       | Subsidiary               | Same disclosures as applicable to the parent company in the accounts of subsidiary company  |
| 3       | Holding Company          | Investments by the loanee in the shares of parent company and subsidiary company, when the company has made a loan or advance in the nature of loan.  |

For the purpose of above disclosures directors’ interest shall have the same meaning as given in Section184 of Companies Act, 2013.

3. The above disclosures shall be applicable to all listed entities except for listed banks.

B. Management Discussion and Analysis:

1. This section shall include discussion on the following matters within the limits set by the listed entity’s competitive position:

   (i) Industry structure and developments.

   (ii) Opportunities and Threats.

   (iii) Segment–wise or product-wise performance.

   (iv) Outlook

   (v) Risks and concerns.

   (vi) Internal control systems and their adequacy.

   (vii) Discussion on financial performance with respect to operational performance.

   (viii) Material developments in Human Resources / Industrial Relations front, including number of people employed.
Lesson 2  

2. Disclosure of Accounting Treatment: Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management’s explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction.

C. Corporate Governance Report:
The following disclosures shall be made in the section on the corporate governance of the annual report.

(1) A brief statement on listed entity’s philosophy on code of governance.

(2) Board of directors:
- composition and category of directors (e.g. promoter, executive, non-executive, independent non-executive, nominee director - institution represented and whether as lender or as equity investor);
- attendance of each director at the meeting of the board of directors and the last annual general meeting;
- number of other board of directors or committees in which a directors is a member or chairperson;
- number of meetings of the board of directors held and dates on which held;
- disclosure of relationships between directors inter-se;
- number of shares and convertible instruments held by nonexecutive directors;
- web link where details of familiarisation programmes imparted to independent directors is disclosed.

(3) Audit committee:
- brief description of terms of reference;
- composition, name of members and chairperson;
- meetings and attendance during the year.

(4) Nomination and Remuneration Committee:
- brief description of terms of reference;
- composition, name of members and chairperson;
- meeting and attendance during the year;
- performance evaluation criteria for independent directors.

(5) Remuneration of Directors:
- all pecuniary relationship or transactions of the non-executive directors vis-à-vis the listed entity shall be disclosed in the annual report;
- criteria of making payments to non-executive directors. alternatively, this may be disseminated on the listed entity’s website and reference drawn thereto in the annual report;
- disclosures with respect to remuneration: in addition to disclosures required under the Companies Act, 2013, the following disclosures shall be made:
  (i) all elements of remuneration package of individual directors summarized under major groups,
such as salary, benefits, bonuses, stock options, pension etc;

(ii) details of fixed component and performance linked incentives, along with the performance criteria;

(iii) service contracts, notice period, severance fees;

(iv) stock option details, if any and whether issued at a discount as well as the period over which accrued and over which exercisable.

(6) Stakeholders’ grievance committee:

- name of non-executive director heading the committee;
- name and designation of compliance officer;
- number of shareholders’ complaints received so far;
- number not solved to the satisfaction of shareholders;
- number of pending complaints.

(7) General body meetings:

- location and time, where last three annual general meetings held;
- whether any special resolutions passed in the previous three annual general meetings;
- whether any special resolution passed last year through postal ballot – details of voting pattern;
- person who conducted the postal ballot exercise;
- whether any special resolution is proposed to be conducted through postal ballot;
- procedure for postal ballot.

(8) Means of communication:

- quarterly results;
- newspapers wherein results normally published;
- any website, where displayed;
- whether it also displays official news releases; and
- presentations made to institutional investors or to the analysts.

(9) General shareholder information:

- annual general meeting - date, time and venue;
- financial year;
- dividend payment date;
- the name and address of each stock exchange(s) at which the listed entity’s securities are listed and a confirmation about payment of annual listing fee to each of such stock exchange(s);
- stock code;
- market price data- high, low during each month in last financial year;
- performance in comparison to broad-based indices such as BSE sensex, CRISIL Index etc;
Lesson 2  Legislative framework of Corporate Governance in India

- in case the securities are suspended from trading, the directors report shall explain the reason thereof;
- registrar to an issue and share transfer agents;
- share transfer system;
- distribution of shareholding;
- dematerialization of shares and liquidity;
- outstanding global depository receipts or American depository receipts or warrants or any convertible instruments, conversion date and likely impact on equity;
- commodity price risk or foreign exchange risk and hedging activities;
- plant locations;
- address for correspondence.

(10) Other Disclosures:
- disclosures on materially significant related party transactions that may have potential conflict with the interests of listed entity at large;
- details of non-compliance by the listed entity, penalties, strictures imposed on the listed entity by stock exchange(s) or the board or any statutory authority, on any matter related to capital markets, during the last three years;
- details of establishment of vigil mechanism, whistle blower policy, and affirmation that no personnel has been denied access to the audit committee;
- details of compliance with mandatory requirements and adoption of the non-mandatory requirements;
- web link where policy for determining ‘material’ subsidiaries is disclosed;
- web link where policy on dealing with related party transactions;
- disclosure of commodity price risks and commodity hedging activities.

(11) Non-compliance of any requirement of corporate governance report of sub-paras (2) to (10) above, with reasons thereof shall be disclosed.

(12) The corporate governance report shall also disclose the extent to which the discretionary requirements as specified in Part E of Schedule II have been adopted.

(13) The disclosures of the compliance with corporate governance requirements specified in regulation 17 to 27 and clauses (b) to (i) of sub-regulation (2) of regulation 46 shall be made in the section on corporate governance of the annual report.

D. Declaration signed by the chief executive officer stating that the members of board of directors and senior management personnel have affirmed compliance with the code of conduct of board of directors and senior management.

E. Compliance certificate from either the auditors or practicing company secretaries regarding compliance of conditions of corporate governance shall be annexed with the directors’ report.

F. Disclosures with respect to demat suspense account/ unclaimed suspense account
The listed entity shall disclose the following details in its annual report, as long as there are shares in the demat suspense account or unclaimed suspense account, as applicable:

- aggregate number of shareholders and the outstanding shares in the suspense account lying at the beginning of the year;
- number of shareholders who approached listed entity for transfer of shares from suspense account during the year;
- number of shareholders to whom shares were transferred from suspense account during the year;
- aggregate number of shareholders and the outstanding shares in the suspense account lying at the end of the year;
- that the voting rights on these shares shall remain frozen till the rightful owner of such shares claims the shares.

Website Disclosures [Regulation (46)]

The listed entity shall maintain a functional website. The listed entity shall ensure that the contents of the website are correct and shall update any change in the content of its website within two working days from the date of such change in content. The listed entity shall disseminate the following information on its website.

(a) details of its business;
(b) terms and conditions of appointment of independent directors;
(c) composition of various committees of board of directors;
(d) code of conduct of board of directors and senior management personnel;
(e) details of establishment of vigil mechanism/Whistle Blower policy;
(f) criteria of making payments to non-executive directors, if the same has not been disclosed in annual report;
(g) policy on dealing with related party transactions;
(h) policy for determining ‘material’ subsidiaries;
(i) details of familiarization programmes imparted to independent directors including the following details:-
   - number of programmes attended by independent directors (during the year and on a cumulative basis till date),
   - number of hours spent by independent directors in such programmes (during the year and on cumulative basis till date), and
   - other relevant details
(j) the email address for grievance redressal and other relevant details;
(k) contact information of the designated officials of the listed entity who are responsible for assisting and handling investor grievances;
(l) financial information including:
   - notice of meeting of the board of directors where financial results shall be discussed;
Lesson 2  =  Legislative framework of Corporate Governance in India

- financial results, on conclusion of the meeting of the board of directors where the financial results were approved;
- complete copy of the annual report including balance sheet, profit and loss account, directors report, corporate governance report etc;

(m) shareholding pattern;

(n) details of agreements entered into with the media companies and/or their associates, etc;

(o) schedule of analyst or institutional investor meet and presentations made by the listed entity to analysts or institutional investors simultaneously with submission to stock exchange;

(p) new name and the old name of the listed entity for a continuous period of one year, from the date of the last name change;

(q) following information published in the newspaper-
  - notice of meeting of the board of directors where financial results shall be discussed
  - financial results, as specified in regulation 33, along-with the modified opinion(s) or reservation(s), if any, expressed by the auditor: Provided that if the listed entity has submitted both standalone and consolidated financial results, the listed entity shall publish consolidated financial results along-with (1) Turnover, (2) Profit before tax and (3) Profit after tax, on a stand-alone basis, as a foot note; and a reference to the places, such as the website of listed entity and stock exchange(s), where the standalone results of the listed entity are available.
  - statements of deviation(s) or variation(s) as specified in sub-regulation (1) of regulation 32 on quarterly basis, after review by audit committee and its explanation in directors report in annual report;

DISCLOSURE REQUIREMENTS UNDER SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015

Disclosures of Trading By Insiders

Regulation 6(2): The disclosures to be made by any person shall include those relating to trading by such person’s immediate relatives, and by any other person for whom such person takes trading decisions.

It is intended that disclosure of trades would need to be of not only those executed by the person concerned but also by the immediate relatives and of other persons for whom the person concerned takes trading decisions. These regulations are primarily aimed at preventing abuse by trading when in possession of unpublished price sensitive information and therefore, what matters is whether the person who takes trading decisions is in possession of such information rather than whether the person who has title to the trades is in such possession.

(3) The disclosures of trading in securities shall also include trading in derivatives of securities and the traded value of the derivatives shall be taken into account for purposes of this Chapter, provided that trading in derivatives of securities is permitted by any law for the time being in force.

(4) The disclosures made shall be maintained by the company, for a minimum period of five years, in such form as may be specified.
Disclosures by certain persons –

Initial Disclosure (Regulation 7 (1))

(a) Every promoter, key managerial personnel and director of every company whose securities are listed on any recognised stock exchange shall disclose his holding of securities of the company as on the date of these regulations taking effect, to the company within thirty days of these regulations taking effect;

(b) Every person on appointment as a key managerial personnel or a director of the company or upon becoming a promoter shall disclose his holding of securities of the company as on the date of appointment or becoming a promoter, to the company within seven days of such appointment or becoming a promoter.

Continual Disclosures: Regulation 7(2)

(a) Every promoter, employee and director of every company shall disclose to the company the number of such securities acquired or disposed of within two trading days of such transaction if the value of the securities traded, whether in one transaction or a series of transactions over any calendar quarter, aggregates to a traded value in excess of ten lakh rupees or such other value as may be specified;

(b) Every company shall notify the particulars of such trading to the stock exchange on which the securities are listed within two trading days of receipt of the disclosure or from becoming aware of such information.

Disclosures by other connected persons

(3) Any company whose securities are listed on a stock exchange may, at its discretion require any other connected person or class of connected persons to make disclosures of holdings and trading in securities of the company in such form and at such frequency as may be determined by the company in order to monitor compliance with these regulations.

This is an enabling provision for listed companies to seek information from those to whom it has to provide unpublished price sensitive information. This provision confers discretion on any company to seek such information. For example, a listed company may ask that a management consultant who would advise it on corporate strategy and would need to review unpublished price sensitive information, should make disclosures of his trades to the company.

Code of Fair Disclosure (Regulation 8)

(1) The board of directors of every company, whose securities are listed on a stock exchange, shall formulate and publish on its official website, a code of practices and procedures for fair disclosure of unpublished price sensitive information that it would follow in order to adhere to each of the principles set out in Schedule A to these regulations, without diluting the provisions of these regulations in any manner.

This provision intends to require every company whose securities are listed on stock exchanges to formulate a stated framework and policy for fair disclosure of events and occurrences that could impact price discovery in the market for its securities. Principles such as, equality of access to information, publication of policies such as those on dividend, inorganic growth pursuits, calls and meetings with analysts, publication of transcripts of such calls and meetings, and the like are set out in the schedule.

(2) Every such code of practices and procedures for fair disclosure of unpublished price sensitive information and every amendment thereto shall be promptly intimated to the stock exchanges where the securities are listed.

This provision is aimed at requiring transparent disclosure of the policy formulated in sub-regulation (1).
SCHEDULE A [Sub-regulation (1) of regulation 8]:


1. Prompt public disclosure of unpublished price sensitive information that would impact price discovery no sooner than credible and concrete information comes into being in order to make such information generally available.

2. Uniform and universal dissemination of unpublished price sensitive unpublished price sensitive information to avoid selective disclosure.

3. Designation of a senior officer as a chief investor relations officer to deal with dissemination of information and disclosure of unpublished price sensitive information.

4. Prompt dissemination of unpublished price sensitive information that gets disclosed selectively, inadvertently or otherwise to make such information generally available.

5. Appropriate and fair response to queries on news reports and requests for verification of market rumours by regulatory authorities.

6. Ensuring that information shared with analysts and research personnel is not unpublished price sensitive information.

7. Developing best practices to make transcripts or records of proceedings of meetings with analysts and other investor relations conferences on the official website to ensure official confirmation and documentation of disclosures made.

8. Handling of all unpublished price sensitive information on a need-to-know basis.

RELATED PARTY TRANSACTIONS

Meaning of related party

As per Ind AS-24, a related party is a person or entity that is related to the entity that is preparing its financial statements (i.e. the ‘reporting entity’)

(a) A person or a close member of that person’s family is related to a reporting entity if that person:

(i) has control or joint control over the reporting entity;

(ii) has significant influence over the reporting entity; or

(iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

(b) An entity is related to a reporting entity if any of the following conditions applies:

(i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

(ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).

(iii) Both entities are joint ventures of the same third party.

(iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
(v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting
entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the
sponsoring employers are also related to the reporting entity.

(vi) The entity is controlled or jointly controlled by a person identified in (a).

(vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key
management personnel of the entity (or of a parent of the entity).

(viii) The entity, or any member of a group of which it is a part, provides key management personnel
services to the reporting entity or to the parent of the reporting entity.

As per Accounting Standard 18

Related party - parties are considered to be related if at any time during the reporting period one party has
the ability to control the other party or exercise significant influence over the other party in making financial
and/or operating decisions.

Definition of related party transaction

Regulation 2(1)(zc) of SEBI(LODR) Regulations, 2015 defines that “related party transaction” means a
transfer of resources, services or obligations between a listed entity and a related party, regardless of
whether a price is charged and a “transaction” with a related party shall be construed to include a single
transaction or a group of transactions in a contract.

Definition of relative

Regulation 2(1)(zd) of SEBI(LODR) Regulations, 2015 specifies that “relative” means relative as defined
under Section 2(77) of the Companies Act, 2013 and rules prescribed there under.

Thus, accordingly “relative”, with reference to any person, means anyone who is related to another, if—

(a) they are members of a Hindu Undivided Family;
(b) they are husband and wife; or
(c) one person is related to the other in the following manner, namely-
   ➢ Father: Provided that the term “Father” includes step-father.
   ➢ Mother: Provided that the term “Mother” includes the step-mother. Son: Provided that the term
     “Son” includes the step-son.
   ➢ Son’s wife
   ➢ Daughter
   ➢ Daughter’s husband
   ➢ Brother: Provided that the term “Brother” includes the step-brother;
   ➢ Sister: Provided that the term “Sister” includes the step-sister.

Section 2(76) of the Companies Act,2013 defines "related party", with reference to a company, as—

(i) a director or his relative;
(ii) a key managerial personnel or his relative;
(iii) a firm, in which a director, manager or his relative is a partner;
(iv) a private company in which a director or manager or his relative is a member or director;

(v) a public company in which a director and manager is a director and holds along with his relatives, more than two per cent of its paid-up share capital;

(vi) any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;

(vii) any person on whose advice, directions or instructions a director or manager is accustomed to act:

Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;

(viii) any body corporate which is—

(A) a holding, subsidiary or an associate company of such company;

(B) a subsidiary of a holding company to which it is also a subsidiary; or

(C) an investing company or the venturer of the company;

Explanation.—For the purpose of this clause, “the investing company or the venturer of a company” means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate.

(ix) such other person as may be prescribed;

Section 188 of the Companies Act, 2013 provides that (1) Except with the consent of the Board of Directors given by a resolution at a meeting of the Board and subject to such conditions as may be prescribed, no company shall enter into any contract or arrangement with a related party with respect to—

(a) sale, purchase or supply of any goods or materials;

(b) selling or otherwise disposing of, or buying, property of any kind;

(c) leasing of property of any kind;

(d) availing or rendering of any services;

(e) appointment of any agent for purchase or sale of goods, materials, services or property;

(f) such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and

(g) underwriting the subscription of any securities or derivatives thereof, of the company:

Provided that no contract or arrangement, in the case of a company having a paid-up share capital of not less than such amount, or transactions not exceeding such sums, as may be prescribed, shall be entered into except with the prior approval of the company by a resolution

Provided further that no member of the company shall vote on such resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party:

Provided also that nothing contained in the second proviso shall apply to a company in which ninety per cent. or more members, in number, are relatives of promoters or are related parties.

Provided also that nothing in this sub-section shall apply to any transactions entered into by the company in its ordinary course of business other than transactions which are not on an arm's length basis.

Provided also that the requirement of passing the resolution under first proviso shall not be applicable for
transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

Section 188 (2) of the Companies Act, 2013 provides that every contract or arrangement entered into under sub-section (1) shall be referred to in the Board’s report to the shareholders along with the justification for entering into such contract or arrangement.

In terms of proviso to Regulation 2(1)(zb) of SEBI (LODR) Regulations, 2015 (as amended), any person or entity belonging to the promoter or promoter group of the listed entity and holding 20% or more of shareholding in the listed entity shall be deemed to be a related party. The Regulations further provide that the listed entity shall submit within 30 days from the date of publication of its standalone and consolidated financial results for the half year, disclosures of related party transactions on a consolidated basis, in the format specified in the relevant accounting standards for annual results to the stock exchanges and publish the same on its website.

In terms of SEBI (LODR) Regulations, 2015 the listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions. A transaction with a related party shall be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds ten percent of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.

Approval of Audit Committee

In terms of Section 177 of the Companies Act, 2013 and in terms of Regulation 23 of SEBI (LODR) Regulations, 2015, all related party transactions shall require prior approval of the audit committee. Audit committee may grant omnibus approval for related party transactions proposed to be entered into by the listed entity subject to the following conditions, namely-

(a) the audit committee shall lay down the criteria for granting the omnibus approval in line with the policy on related party transactions of the listed entity and such approval shall be applicable in respect of transactions which are repetitive in nature;

(b) the audit committee shall satisfy itself regarding the need for such omnibus approval and that such approval is in the interest of the listed entity;

(c) the omnibus approval shall specify:
   (i) the name(s) of the related party, nature of transaction, period of transaction, maximum amount of transactions that shall be entered into,
   (ii) the indicative base price / current contracted price and the formula for variation in the price if any; and
   (iii) such other conditions as the audit committee may deem fit provided where the need for related party transaction cannot be foreseen and aforesaid details are not available, audit committee may grant omnibus approval for such transactions subject to their value not exceeding rupees one crore per transaction.

(d) the audit committee shall review, at least on a quarterly basis, the details of related party transactions entered into by the listed entity pursuant to each of the omnibus approvals given.

(e) Such omnibus approvals shall be valid for a period not exceeding one year and shall require fresh approvals after the expiry of one year:
Omnibus approval shall not be made for transactions in respect of selling or disposing of the undertaking of the company.

Policy on materiality of related party transactions: The listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions.

When will a transaction with a related party be material?

A transaction with a related party shall be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds 10% of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.

Approval of the shareholders

All material related party transactions shall require approval of the shareholders through resolution and the related parties shall abstain from voting on such resolutions whether the entity is a related party to the particular transaction or not.

Exceptions

The approval of Audit committee and shareholders shall not be required in the following cases:

(a) transactions entered into between two government companies;
(b) transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

"Government company(ies)" means Government company as defined in sub-section (45) of section 2 of the Companies Act, 2013.

Other provisions

- The provisions of this regulation shall be applicable to all prospective transactions.
- For the purpose of this regulation, all entities falling under the definition of related parties shall abstain from voting irrespective of whether the entity is a party to the particular transaction or not.
- SEBI (LODR) Regulations, 2015 have allowed the related parties to cast a negative vote as such voting cannot be considered to be in conflict of interest.
- All existing material related party contracts or arrangements entered into prior to the date of notification of these regulations and which may continue beyond such date shall be placed for approval of the shareholders in the first General Meeting subsequent to notification of these regulations.
- A transaction involving payments made to a related party with respect to brand usage or royalty shall be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceed two percent of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.

Further, as a part of ‘Related Party Disclosures’ in the annual report, disclosures of transactions of the listed entity with any person or entity belonging to the promoter/promoter group which hold(s) 10% or more shareholding in the listed entity, in the format prescribed in the relevant accounting standards for annual results have been mandated.

VIGIL MECHANISM AND WHISTLE BLOWER

Case Example: Enron, a Houston-based energy company founded by a brilliant entrepreneur, Kenneth Lay.
The company was created in 1985 by a merger of two American gas pipeline companies in Nebraska and Texas. Lay assumed the role of chairperson and CEO, a position he held through most of the next 16 years, until the company's downfall in 2001. In a period of 16 years the company was transformed from a relatively small concern, involved in gas pipelines, oil and gas exploration, to the world's largest energy trading company. In 2001 Enron became a household name—and probably in most households in most countries around the world. On 2 December, 2001 Enron, one of the 10 largest companies in the US, filed for bankruptcy.

During the boom years of the late 1990s the company positioned itself as a trader of virtually any type of asset: pulp and paper, weather derivatives, commodities, credits, and so on. It also expanded into areas that it thought would benefit from rapid growth, including water (following deregulation measures), fiber optic capacity/Internet bandwidth, and so on. At the end of 1999, Enron launched its Internet based trading platform—Enron online. In February 2001, the company's stock market value was USD 4.60 billion.

In early 2001, as Lay handed the CEO role to Skilling, Enron reached an apex: the company reported revenues of US $ 100 billion and ranked seventh on the Fortune 500 list of largest global companies.

In early 2001, however, the company's problems started mounting: the expensive expansion into the broadband sector became questionable. Enron's stock prices started falling. In August 2001 the chief executive Jeffery Skilling, left the company following concerns about the company's management. Former CEO Lay returned to his old role (retaining the board chair as well).

Whistleblowers within the firm—aware of widespread financial improprieties—were attempting to convey information to the board of directors; one employee, Sherron Watkins, Enron's vice president of corporate development, was finally successful in alerting certain board members that all was not well. In November 2001, it became clear that Enron was facing serious financial problems.

### Meaning and Definition

The term “whistle-blowing” originates from the practice of British policemen who blew their whistles whenever they observed commission of a crime. The term ‘whistle-blowing’ is a relatively recent entry into the vocabulary of public and corporate affairs although the phenomenon itself is not new.

The concept of a Whistleblower was in existence even in Ancient India, Kautilya had proposed- “Any informant (súchaka) who supplies information about embezzlement just under perpetration shall, if he succeeds in proving it, get as reward one-sixth of the amount in question; if he happens to be a government servant (bhritaka), he shall get for the same act one-twelfth of the amount.”

The term whistle blowing probably arises by analogy with the referee or umpire who draws public attention to a foul in a game by blowing of the whistle which would alert both the law enforcement officers and the general public of danger.

Whistle blowers are individuals who expose corruption and fraud in organizations by filing a law suit or a complaint with Government authorities that prompts a criminal investigation in to the organizations alleged behavior.

Whistle blowing means calling the attention of the top management to some wrongdoing occurring within an organization. A whistleblower may be an employee, former employee or member of an organisation, a government agency, who have willingness to take corrective action on the misconduct.

A whistleblower is a person who publicly complains concealed misconduct on the part of an organization or a body of people, usually from within that same organisation. This misconduct may be classified in many ways:
for example, a violation of a law, rule, regulation and/or a direct threat to the public interest, such as fraud, health/safety violations, and corruption. Whistleblowers frequently the face retaliation - sometimes at the hands of the organisation or the group which they have accused, unless a system is in place that would ensure confidentiality. In addition, people are more likely to take action with respect to unacceptable behavior within an organization, if there are complaint systems that ensure confidentiality and indemnity.

US civic activist Ralph Nader coined the phrase in the early 1970s to avoid the negative connotations found in other words such as "informers" and "snitches".

Some important Definitions of whistle blowing are:

- R.M Green (1994) defines a whistleblower as an Employee who, perceiving an organizational practice that he believes to be illegal or unethical, seeks to stop this practice by alerting top management or failing that by notifying authorities outside the organization.

- Sekhar (2002) defines whistleblowing as an attempt by an employee or a former employee of an organization to disclose what he proclaims to be wrong doing in or by that organization.

- Koehn (2003) whistle blowing occurs when an employee informs the public of inappropriate activities going on inside the organization.

- Boatright (2003) whistle blowing is the release of information by a member or former member of an organization this is evidence of illegal and/or immoral conduct in the organization that is not in the public interest.

Types of Whistleblowers

1. Internal: When the whistleblower reports the wrong doings to the officials at higher position in the organization. The usual subjects of internal whistle blowing are disloyalty, improper conduct, indiscipline, insubordination, disobedience etc.

2. External: Where the wrongdoings are reported to the people outside the organization like media, public interest groups or enforcement agencies it is called external whistle blowing.

3. Alumini: When the whistle blowing is done by the former employee of the organization it is called alumini whistle blowing.

4. Open: When the identity of the whistleblower is revealed, it is called Open Whistle Blowing.

5. Personal: Where the organizational wrongdoings are to harm one person only, disclosing such wrong doings it is called personal whistle blowing.

6. Impersonal: When the wrong doing is to harm others, it is called impersonal whistle blowing.

7. Government: When a disclosure is made about wrong doings or unethical practices adopted by the officials of the Government.

8. Corporate: When a disclosure is made about the wrongdoings in a business corporation, it is called corporate whistle blowing.

Whistle Blowing under Sarbanes-Oxley Act, 2002 (SOX)

Section 302 of Sarbanes Oxley Act of 2002, an Act enacted by U.S. congress to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for
other purposes contains following provisions for whistle-blowers:

- Make it illegal to “discharge, demote, suspend, threaten, harass or in any manner discriminate against” whistleblowers
- Establish criminal penalties of up to 10 years for executives who retaliate against whistleblowers
- Require board audit committees to establish procedures for hearing whistleblower complaints
- Allow the secretary of labour to order a company to rehire a terminated employee with no court hearing.
- Give a whistleblower the right to a jury trial, bypassing months or years of administrative hearings

**Whistle Blowing mechanism suggested under Corporate Governance Voluntary Guidelines, 2009**

- The companies should ensure the institution of a mechanism for employees to report concerns about unethical behaviour, actual or suspected fraud, or violation of the company's code of conduct or ethics policy.
- The companies should also provide for adequate safeguards against victimization of employees who avail of the mechanism, and also allow direct access to the Chairperson of the Audit Committee in exceptional cases.

**Vigil Mechanism under Companies Act, 2013**

1. Every listed company and the companies belonging to the following class or classes shall establish a vigil mechanism for their directors and employees to report their genuine concerns or grievances-
   
   (a) the Companies which accept deposits from the public;
   
   (b) the Companies which have borrowed money from banks and public financial institutions in excess of fifty crore rupees.

   (Section 177(9) and Rule 7(1) of Companies (Meetings of Board and its Powers) Rules, 2014)

2. The vigil mechanism under sub-section (9) shall provide for adequate safeguards against victimisation of persons who use such mechanism and make provision for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases. [Section 177(10)]

3. The details of establishment of such mechanism shall be disclosed by the company on its website, if any, and in the Board's report. [proviso to Section 177(10)]

4. The companies which are required to constitute an audit committee shall oversee the vigil mechanism through the committee and if any of the members of the committee have a conflict of interest in a given case, they should recuse themselves and the others on the committee would deal with the matter on hand. [Rule 7(2) of Companies (Meetings of Board and its Powers) Rules, 2014]

5. In case of other companies, the Board of directors shall nominate a director to play the role of audit committee for the purpose of vigil mechanism to whom other directors and employees may report their concerns. [Rule 7(3) of Companies (Meetings of Board and its Powers) Rules, 2014]

6. The vigil mechanism shall provide for adequate safeguards against victimisation of employees and directors who avail of the vigil mechanism and also provide for direct access to the Chairperson of the Audit Committee or the director nominated to play the role of Audit Committee, as the case may
be, in exceptional cases. [Rule 7(4) of Companies (Meetings of Board and its Powers) Rules, 2014)]

7. In case of repeated frivolous complaints being filed by a director or an employee, the audit committee or the director nominated to play the role of audit committee may take suitable action against the concerned director or employee including reprimand. [Rule 7(5) of Companies (Meetings of Board and its Powers) Rules, 2014)]

**Vigil mechanism under SEBI Listing Obligations and Disclosure Requirements, 2015**

1. The listed entity shall formulate a vigil mechanism for directors and employees to report genuine concerns.

2. The vigil mechanism shall provide for adequate safeguards against victimization of director(s) or employee(s) or any other person who avail the mechanism and also provide for direct access to the chairperson of the audit committee in appropriate or exceptional cases.

3. The listed entity shall disseminate the details of establishment of vigil mechanism/ Whistle Blower policy.

4. The disclosure regarding the details of establishment of vigil mechanism, whistle blower policy, and affirmation that no personnel has been denied access to the audit committee shall be made in the section on the corporate governance of the annual report.

**GLOSSARY OF TECHNICAL WORDS**

- **Corporate Governance**: Corporate governance refers to the mechanisms, relations, and processes by which a corporation is controlled and is directed; involves balancing the many interests of the stakeholders of a corporation.

- **BIFR**: The Board for Industrial and Financial Reconstruction (BIFR) was an agency of the Government of India in order to determine sickness of industrial companies and to assist in reviving those that may be viable and shutting down the others.

- **Audit Committee**: An audit committee is the section of an organization’s board of directors that is in charge of monitoring an organization’s financial reporting and authenticating its accuracy.

- **Vigil Mechanism**: It is a mechanism called ‘Vigil Mechanism’ for all the Directors and employees to report to the management instances of unethical behavior, actual or suspected fraud or violation of the Company’s code of conduct or ethics policy.

- **Global Depository Receipt**: A global depositary receipt or GDR is a bank certificate issued in more than one country for shares in a foreign company.

**LESSON ROUND-UP**

- Legal and regulatory framework of corporate governance in India is mainly covered under the Companies Act, 2013, Listing Agreement and SEBI guidelines. However, it is not restricted to only SEBI Guidelines and the Companies Act, 2013. A gamut of legislations like The Competition Act, the Consumer Protection laws, the labour laws, the environment laws, the Money Laundering Laws etc seeks to ensure good governance practices among the corporates.

- The Securities and Exchange Board of India (SEBI) is the prime regulatory authority which regulates all aspects of securities market enforces the Securities Contracts (Regulation) Act including the stock
Company exchanges. Companies that are listed on the stock exchanges are required to comply with the Listing Agreement.

- The following are the major legislations/regulations/guidelines on transparency and disclosure
  - Companies Act, 2013
  - SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009
  - SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
  - SEBI (Prohibition of Insider Trading) Regulations, 2015
  - SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

- A whistleblower is a person who publicly complains concealed misconduct on the part of an organization or a body of people, usually from within the same organization. It is now a mandatory requirement for Listed companies.

### SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Describe how the Indian Legislative framework supports transparency and disclosure by corporates.

2. Write a brief note on
   - (a) Regulators and regulations in India pertaining to Corporate Governance
   - (b) Disclosures to be made under Listing Regulations, 2015.
   - (c) Shareholders rights

3. What is the provision for Board composition in the Listing Regulations, 2015?

4. Explain the Role and Importance of Remuneration Committee.

5. Write short notes on the following:
   - Whistle Blower Policy/Mechanism
   - Disclosure under Corporate Governance Report
   - Separation of Role of Chairman and CEO
   - Independent Director
Lesson 3
Corporate Governance in Banks, Insurance and Public Sector Companies

LESSON OUTLINE

• Corporate Governance norms for Bank/ Insurance/ Public Sector Companies
• Classification of Banks
• Regulations of Banks
  ➢ SBI Act, 1955
  ➢ Banking Companies (Acquisition & Transfer of Undertakings) Act, 1970
  ➢ Banking Regulation Act, 1949
  ➢ SEBI (LODR) Regulations, 2015
• Ganguly Committee recommendations on CG in India
• Basel Committee on Corporate Governance
• Corporate Governance Developments in Banks
• Corporate Governance of NBFC’s
• Corporate Governance in Insurance Companies
• Stewardship Code for Insurers in India
• Corporate Governance in Public Sector Enterprises
• CSR & Sustainability for Central Public Enterprises
• Glossary
• Lesson Round Up
• Self Test Questions

LEARNING OBJECTIVES

The objective of the study lesson is to enable the students to understand legislative framework of Corporate Governance in the Banks, Insurance Companies and Public Sector Undertakings (PSUs).

The Companies Act, 2013 is applicable to all companies registered under the Act. However the same is not the case with nationalized banks as these are governed by separate Acts. The chapter explains the Ganguly Committee Report on Corporate Governance in Banks, and Corporate Governance under the Basel I, II and III. The Insurance companies are also subject to compliance with IRDA guidelines in addition to other applicable legislations. The guidelines issued by the IRDA on the Corporate Governance norms applicable to the Insurance Company have been dealt with in the chapter.

The PSUs/CPSEs are subject to additional supervision and compliance of DPE/Vigilance/C&AG directives as compare to the private sector companies.

The study aims to enable the students to understand the aforesaid sector specific governance structure.

The CSR and Sustainability for the Central Public Enterprises provisions as per Companies Act 2013 which are applicable to CPEs have been included in it.

This chapter provides basic knowledge about the principles, theory and concepts of Corporate Governance in Insurance and Public Sector Companies in India.

“We have now moved from diversified ecology of small banks, with varied lending policies to a more homogeneous framework of firms that all resemble one another”

– Nassim Nicholas Tateb
CORPORATE GOVERNANCE NORMS FOR BANKS/INSURANCE/PUBLIC SECTOR COMPANIES

The sector specific companies i.e. banking/insurance/public sector, may be listed or unlisted companies. If they are listed with any stock exchanges, they have to adhere to the listing agreements. The provisions of the Companies Act, 2013 are also applicable to both listed as well as unlisted companies. However, since these companies are sector specific hence they are required to follow the regulatory norms prescribed by their sectoral regulator. For example: Banks are governed by the Banking Regulation Act, 1949 and come under the control of the Reserve Bank of India. Hence directions of the RBI have to be followed. Similarly the insurance companies comes under the purview of the IRDA so apart from the Listing Regulations (if they are listed companies) and the Companies Act, 2013, they also have to adhere the norms prescribes by the RBI/IRDA etc.

CLASSIFICATION OF BANKS

Banks may be classified as Scheduled and Non-scheduled commercial banks.

(a) Scheduled bank: As per section 2(e) of The Reserve Bank of India Act, 1934, ‘scheduled bank’ means a bank included in the Second Schedule.

Conditions for inclusion of name of a bank in Second Schedule: Section 42(6)(a) of the RBI Act, 1934 narrates the following conditions for inclusion of the name of a bank in the Second Schedule:

(i) has a paid-up capital and reserves of an aggregate value of not less than five lakhs of rupees, and

(ii) satisfies the Bank (RBI) that its affairs are not being conducted in a manner detrimental to the interests of its depositors, and

(iii) is a State co-operative bank or a company as defined in section 3 of the Companies Act, 1956, or an institution notified by the Central Government in this behalf or a corporation or a company incorporated by or under any law in force in any place outside India.

Conditions for exclusion of name of a bank from the Second Schedule: Section 42(6)(b) of the RBI Act, 1934 narrates the following conditions for exclusion of name of a bank from the Second Schedule:

(i) the aggregate value of whose paid-up capital and reserves becomes at any time less than five lakhs of rupees, or

(ii) which is, in the opinion of the Bank after making an inspection under section 35 of the Banking Regulation Act, 1949 (10 of 1949), conducting its affairs to the detriment of the interests of its depositors, or,

(iii) which goes into liquidation or otherwise ceases to carry on banking business.

Provided that the Bank may, on application of the scheduled bank concerned and subject to such conditions, if any, as it may impose, defer the making of a direction under sub-clause (i) or sub-clause (ii) of clause (b) for such period as the Bank considers reasonable to give the scheduled bank an opportunity of increasing the aggregate value of its paid-up capital and reserves to not less than five lakhs of rupees or, as the case may be, of removing the defects in the conduct of its affairs;

Scheduled banks are required to maintain Cash Reserve Ratio (CRR) with RBI in terms of section 42(1) of
the RBI Act, 1934 and also maintain Statutory Liquidity Ratio (SLR) in terms of section 24 of the Banking Regulation Act, 1949 (BR Act).

Section 42 (1) of the RBI Act provides that every bank included in the Second Schedule shall maintain with the Bank an average daily balance the amount of which shall not be less than such per cent of the total of the demand and time liabilities in India of such bank as shown in the return referred to in sub-section (2), as the Bank may from time to time, having regard to the needs of securing the monetary stability in the country, notify in the Gazette of India.

Section 24 (2A) of the BR Act provides that a scheduled bank, in addition to the average daily balance which it is, or may be, required to maintain under section 42 of the Reserve Bank of India Act, 1934 (2 of 1934) and every other banking company, in addition to the cash reserve which it is required to maintain under section 18, shall maintain in India, assets, the value of which shall not be less than such percentage not exceeding forty per cent of the total of its demand and time liabilities in India as on the last Friday of the second preceding fortnight as the Reserve Bank may, by notification in the Official Gazette, specify from time to time and such assets shall be maintained, in such form and manner, as may be specified in such notification.

(b) Non-scheduled bank: It means those banks, whose names have not been included in the Second Schedule of the RBI Act, 1934. The non-scheduled banks are required to maintain by way of cash reserve with itself or with RBI in terms of section 18 of the Banking Regulation Act, 1949.

The banks may also be classified in the following way:


- **SBI Associate Banks merged with SBI**: The merger with SBI's five associate banks was approved by the Central Government in February, 2017. The merged names of the Associate Banks were State Bank of Patiala, State Bank of Bikaner and Jaipur, State Bank of Raipur, State Bank of Travancore, State Bank of Hyderabad as well as with Bhartiya Mahila Bank (BMB) with effect from October 1, 2017.

- **Nationalised Banks**: In 1969, the Government of India issued an Ordinance, Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969, and 14 scheduled commercial banks were nationalised in order to expand the branch network, followed by six more in 1980. The ordinance was thereafter enacted as Act namely The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and The Banking Companies (Acquisition and Transfer of Undertakings) act, 1980. These nationalised banks are called the Govt. of India Undertakings.

  **First round of nationalisation**: (19th July, 1969)-


  **Second round of nationalised (15th April, 1980)**

  (1) Punjab and Sind bank, (2) Vijaya bank, (3) Oriental bank of India, (4) Corporate bank, (5) Andhra bank, (6) New bank of India- **(Later it was merged with PNB)**

- **Old/New Private Sector Banks**: The ownership of these banks are scattered among the individuals, institutions, mutual funds and companies and are not the Government banks, but they are governed and
controlled by the RBI guidelines and directives. Among old private sector banks, it includes J & K Bank, Federal Bank etc and ICICI Bank, HDFC Bank, Axis Bank etc. are the new generation banks.

• **State/District Co-operative Banks:** A cooperative bank is a cooperative society registered or deemed to have been registered under any State or Central Act. If a cooperative bank is operating in more than one State, the Central Cooperative Societies Act is applicable. In other cases the State laws are applicable. Apart from various other laws like the Banking Laws (Application to Co-operative Societies) Act, 1965 and Banking Regulation (Amendment) and Miscellaneous Provisions Act, 2004, the provisions of the RBI Act, 1934 and the BR Act, 1949 would also be applicable for governing the banking activities.

• **Regional Rural Banks (RRBs):** These banks were established under The Regional Rural Banks Act, 1976. These banks are sponsored by nationalized banks and the capital contribution is in the ratio of 50% by Central Govt., 15% by State Govt. and 35% by the concerned sponsored bank. These banks established with the focused attention of the local villagers financial needs.

• **Local Area Banks (LABs):** Local Area Banks with operations in two or three contiguous districts were conceived in the 1996 Union budget to mobilise rural savings and make them available for investments in local areas. They are expected to bridge the gaps in credit availability and enhance the institutional credit framework in rural and semi-urban areas. Although the geographical area of operation of such banks is limited, they are allowed to perform all functions of a scheduled commercial bank.

• **Foreign Banks:** The other important segment of the commercial banking is that of foreign banks. Foreign banks have their registered offices outside India, and through their branches they operate in India. Foreign banks are allowed on reciprocal basis. They are allowed to operate through branches or wholly owned subsidiaries.

### REGULATION OF BANKS

As discussed above, we have seen that the banks have been established under the different statutes. The SBI is governed by the State Bank of India Act, 1955, Nationalized banks are governed by the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980. The private sector banks came into being as company registered under the Companies Act (whether under the Companies Act, 2013/1956 or under the Indian Companies Act, 1913 or prior to that).

**(A) State Bank of India Act 1955:** Section 19 of the Act deals with the Composition of the Central Board. It provides that Central Board shall consist of the following, namely:-

(a) Chairman to be appointed by the Central Government in consultation with the Reserve Bank.

(b) Such number of managing directors **not exceeding four**, as may be appointed by the Central Government in consultation with the Reserve Bank.

(c) If the total amount of the holdings of the shareholders, other than the Central Government, whose names are on the register of shareholders three months before the date fixed for election of directors is -

   (i) not more than ten per cent of the total issued capital, two directors,

   (ii) more than ten percent but not more than twenty-five percent of such capital, three directors, and

   (iii) more than twenty-five per cent of such capital, four directors, to be elected in the prescribed manner by such shareholders;
(ca) one director, from among the employees of the State Bank, who are workmen, to be appointed by the Central Government in the manner provided in the rules made under this Act;

(cb) one director, from among such of the employees of the State Bank, as are not workmen, to be appointed by the Central Government in the manner provided in the rules made under this Act;

(d) not less than two and not more than six directors to be nominated by the Central Government from among persons having special knowledge of the working of co-operative institutions and of rural economy or experience in commerce, industry, banking or finance;

(e) one director to be nominated by the Central Government; and

(f) one director, possessing necessary expertise and experience in matters relating to regulation or supervision of commercial banks to be nominated by the Central Government on the recommendation of the Reserve Bank.

(B) Banking Companies [(Acquisition and Transfer of Undertakings) Act, 1970]

Section 9(3) of the said Act provides that every Board of Directors of a corresponding new bank constituted under any scheme made under sub-section (1), shall include-

(a) not more than four whole time Directors to be appointed by the Central Government after consultation with the Reserve Bank;

(b) one Director who is an official of the Central Government to be nominated by the Central Government:

Provided that no such Director shall be a Director of any other corresponding new bank.

Explanation: For the purposes of this clause, the expression "corresponding new bank" shall include a corresponding new bank within the meaning of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980);

(c) one director, possessing necessary expertise and experience in matters relating to regulation or supervision of commercial banks, to be nominated by the Central Government on the recommendation of the Reserve Bank;

Explanation: For the purposes of this clause, "an officer of the Reserve Bank" includes an officer of the Reserve Bank who is deputed by that bank under Section 54AA of the Reserve Bank of India Act, 1934 (2 of 1934) to any institution referred to therein;

(d) Omitted by amendment dated 25.09.06, effective 16.10.06.

(e) one Director, from among such of the employees of the corresponding new bank who are workmen under clause (s) of section 2 of the Industrial Disputes Act, 1947 (14 of 1947) to be nominated by the Central Government in such manner as may be specified in a scheme made under this section;

(f) one Director, from among the employees of the corresponding new bank who are not workmen under clause(s) of section 2 of the Industrial Disputes Act, 1947, (14 of 1947) to be nominated by the Central Government after consultation with the Reserve Bank;

(g) one Director who has been a Chartered Accountant for not less than fifteen years to be nominated by the Central Government after consultation with the Reserve Bank;

(h) subject to the provisions of clause (i), not more than six Directors to be nominated by the Central Government;
(i) where the capital issued under clause (c) of sub-section (2B) of section (3) is-

I. not more than sixteen per cent of the total paid-up capital, one director;

II. more than sixteen per cent but not more than thirty two per cent of the total paid-up capital, two directors,

III. more than thirty two per cent of the total paid-up capital, three directors, to be elected by the shareholders, other than the Central Government, from amongst themselves:

Provided that on the assumption of charge after election of any such director under this clause, equal number of directors nominated under clause (h) shall retire in such manner as may be specified in the scheme.

Provided further that in case the number of directors elected, on or before the commencement of the Banking Companies (Acquisition and Transfer of Undertakings) and Financial Institutions Laws (Amendment) Act, 2006 in a corresponding new Bank exceed the number of directors specified in sub-clause (I) or sub- clause (II) or sub – clause (III), as the case may be, such excess number of directors elected before such commencement shall retire in such manner as may be specified in the scheme and such directors shall not be entitled to claim any compensation for the premature retirement of their term of office.

Section 9 (3A): The Directors to be nominated under clause (h) or to be elected under clause (i) of sub-section (3) shall-

- have special knowledge or practical experience in respect of one or more of the following. matters namely,- (i) agricultural and rural economy, (ii) banking, (iii) co-operation, (iv) economics, (v) finance, (vi) law, (vii) small scale industry, (viii) any other matter the special knowledge of, and practical experience in, which would, in the opinion of the Reserve Bank, be useful to the corresponding new bank;

- represent the interests of depositors; or

- represent the interest of farmers, workers and artisans.

Section 9 (3AA): Without prejudice to the provisions of sub section (3A) and notwithstanding anything to the contrary contained in this Act or in any other law for the time being in force, no person shall be eligible to be elected as director under clause (i) of sub section (3) unless he is a person having fit and proper status based upon track record, integrity and such other criteria as the Reserve Bank may notify from time to time in this regard.

Section 9 (3AB): The Reserve Bank may also specify in the notification issued under sub section (3AA), the authority to determine the fit and proper status, the manner of such determination, the procedure to be followed for such determination and such other matters as may be considered necessary or incidental thereto.

Section 9 (3B): Where the Reserve Bank is of the opinion that any Director of a corresponding new bank elected under clause (i) of sub-section (3) does not fulfill the requirements of sub-sections (3A) and (3AA), it may, after giving to such Director and the bank a reasonable opportunity of being heard, by order, remove such Director and on such removal, the Board of Directors shall co-opt any other person fulfilling the requirements of sub-sections (3A) and (3AA) as a Director in place of the person so removed till a Director is duly elected by the shareholders of the corresponding new bank in the next annual general meeting and the person so co-opted shall be deemed to have been duly elected by the shareholders of the corresponding new bank as a Director.
(C) **Banking Regulation Act, 1949 (BR Act):** The law relating to the banking is governed by the BR Act 1949. Section 2 of the BR Act provides that the provisions of this Act shall be in addition to, and not, save as hereinafter expressly provided, in derogation of the Companies Act, 1956 (now CA 2013), and any other law for the time being in force.

Section 35 of the BR Act gives a right to RBI to undertake the inspection of any banking company. RBI has also got powers by virtue of section 35A of the BR Act, to give directions to the banking company.

**Board of Directors to include persons with professional or other experience:** Section 10A of the BR Act provides that:

1. Notwithstanding anything contained in any other law for the time being in force, every banking company,—
   1. in existence on the commencement of Section 3 of the Banking Laws (Amendment) Act, 1968 (59 of 1968), or
   2. which comes into existence thereafter,
   shall comply with the requirements of this section:

   **Provided that** nothing contained in this sub-section shall apply to a banking company referred to in Cl.(a) for a period of three months from such commencement.

2. Not less than fifty-one per cent of the total number of members of the Board of Directors of a banking company shall consist of persons, who—

   1. shall have special knowledge or practical experience in respect of one or more of the following matters, namely:
      i. accountancy, (ii) agriculture and rural economy, (iii) banking, (iv) co-operation, (v) economics, (vi) finance, (vii) law, (viii) small-scale industry, (ix) any other matter, the special knowledge of, and practical experience in, which would, in the opinion of the Reserve Bank, be useful to the banking company:

      **Provided that** out of the aforesaid number of directors, not less than two shall be persons having special knowledge or practical experience in respect of agriculture and rural economy, co-operation or small-scale industry; and

   2. shall not—

      1. have substantial interest in, or be connected with, whether as employee, manager or managing agent,—

      i. any company, not being a company registered under Sec. 25 of the Companies Act, 1956 (1 of 1956), or
      ii. any firm, which carries on any trade, commerce or industry and which, in either case, is not a small-scale industrial concern, or

      2. be proprietors of any trading commercial or industrial concern, not being a small-scale industrial concern.

2-A Notwithstanding anything to the contrary contained in the Companies Act, 1956 (1 of 1956), or in any other law for the time being in force,—
(i) no director of a banking company, other than its Chairman or whole-time director, by whatever name called, shall hold office continuously for a period exceeding eight years;

(ii) a Chairman or other whole-time director of a banking company who has been removed from office as such Chairman or whole time director, as the case may be, under the provisions of this Act, shall also cease to be a director of the banking company and shall also not be eligible to be appointed as a director of such banking company, whether by election or co-option or otherwise, for a period of four years from the date of his ceasing to be the Chairman or whole-time director, as the case may be.

(3) If, in respect of any banking company, the requirements, as laid down in sub-section (2) are not fulfilled at any time, the Board of Directors of such banking company shall re-constitute such Board so as to ensure that the said requirements are fulfilled.

(4) If, for the purpose of re-constituting the Board under sub-section (3) it is necessary to retire any director or directors, the Board may, by lots drawn in such manner as may be prescribed, decide which director or directors shall cease to hold office and such decision shall be binding on every director of the Board.

(5) Where the Reserve Bank is of opinion that the composition of the Board of Directors of a banking company is such that it does not fulfil the requirements of sub-section (2), it may, after giving to such banking company reasonable opportunity of being heard, by an order in writing, direct the banking company to so reconstitute its Board of Directors as to ensure that the said requirements are fulfilled and, if within two months from the date of receipt of that order, the banking company does not comply with the directions made by the Reserve Bank, that bank may, after determining by lots drawn in such manner as may be prescribed, the person who ought to be removed from the membership of the Board of Directors, remove such person from the office of the director of such banking company and with a view to complying with the provisions of sub-section (2), appoint a suitable person as a member of the Board of Directors in the place of the person so removed whereupon the person so appointed shall be deemed to have been duly elected by the banking company as its director.

(6) Every appointment, removal or reconstitution duly made and every election duly held, under this section shall be final and shall not be called into question in any Court.

(7) Every director elected or, as the case may be, appointed under this section shall hold office until the date upto which his predecessor would have held office, if the election had not been held, or, as the case may be, the appointment had not been made.

(8) No act or proceeding of the Board of Directors of a banking company shall be invalid by reason only of any defect in the composition thereof or on the ground that it is subsequently discovered that any of its members did not fulfil the requirements of this section.

Banking company to be managed by whole-time Chairman:

Section 10B of BR Act provides that:

(1) Notwithstanding anything contained in any law for the time being in force or in any contract to the contrary, every banking company in existence on the commencement of the Banking Regulation (Amendment) Act, 1994, or which comes into existence thereafter shall have one of its directors, who may be appointed on a whole-time or a part-time basis as Chairman of its Board of Directors, and where he is appointed on a whole-time basis, as Chairman of its Board of Directors, he shall be entrusted with the management of the whole of the affairs of the banking company: Provided that the Chairman shall exercise his powers subject to the superintendence, control and direction of the Board of directors. Provided further that nothing in this sub-section shall apply to a banking company in existence on the commencement of the
sai'd section for a period of three months from such commencement. (1-A) Where a Chairman is appointed on a part-time basis,—

(i) such appointment shall be with the previous approval of the Reserve Bank and be subject to such conditions as the Reserve Bank may specify while giving such approval;

(ii) the management of the whole of the affairs of such banking company shall be entrusted to a managing director who shall exercise his powers subject to the Superintendence, control and direction of the Board of directors.

(2) Every Chairman of the Board of Directors who is appointed on a whole-time basis and every managing director of a banking company shall be in the whole-time employment of such company and shall hold office for such period, not exceeding five years, as the Board of Directors may fix, but shall, subject to the provisions of the section, be eligible for re-election or re-appointment:

Provided that nothing in this sub-section shall be construed as prohibiting a Chairman from being a director of a subsidiary of the banking company or a director of a company registered under Sec. 25 of the Companies Act, 1956.

(3) Every person holding office on the commencement of Sec. 3 of the Banking Laws (Amendment) Act, 1968, as managing director of the banking company shall—

(a) if there is a Chairman of its Board of Directors, vacate office on such commencement, or

(b) if there is no Chairman of its Board of Directors, vacate office on the date on which the Chairman of its Board of Directors is elected or appointed in accordance with the provisions of this section.

(4) Every Chairman who is appointed on a whole-time basis and every Managing Director of a banking company appointed under sub-section (1-A) shall be a person who has special knowledge and practical experience of—

(a) the working of a banking company, or of the State Bank of India or any subsidiary bank or financial institution; or

(b) financial, economic or business administration:

Provided that a person shall be disqualified for being 'Chairman who is appointed on a whole-time basis as a Managing Director, if he—

(a) is a director of any company other, than a company referred to in the proviso to sub-section (2); or

(b) is a partner of any firm which carries on any trade, business or industry; or

(c) has substantial interest in any other company or firm; or

(d) is a director, manager, managing agent, partner or proprietor of any trading, commercial or industrial concern; or

(e) is engaged in any other business or vocation.

(5) A Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director of a banking company may, by writing under his hand addressed to the company, resign his office.

(5-A) A Chairman of the Board of Directors appointed on a whole-time basis or Managing Director whose term of office has come to an end, either by reason of his resignation or by reason of expiry of the period of his office, shall, subject to the approval of the Reserve Bank continue in office until his successor assumes
(6) Without prejudice to the provisions of Sec. 36-AA, where the Reserve Bank is of opinion that any person who is, or has been elected to be, the Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director of a banking company is not a fit and proper person to hold such office, it may, after giving to such person and to the banking company a reasonable opportunity of being heard, by order in writing require the banking company to elect or appoint any other person as the Chairman of the Board of Directors who is appointed on a whole time basis or a Managing Director and if, within a period of two months from the date of receipt of such order, the banking company fails to elect or appoint a suitable person as the Chairman of the Board of Directors, who is appointed on a whole-time basis or a Managing Director of the banking company and appoint a suitable person in his place whereupon the person so appointed shall be deemed to have been duly elected or appointed, as the case may be, as the Chairman of the Board of Directors appointed on a whole-time basis or Managing Director of such banking company and any person elected or appointed as chairman on a whole-time basis or managing director under this sub-section shall hold office for the residue of the period of office of the person in whose place he has been so elected or appointed.

(7) The banking company and any person against whom an order of removal is made under sub-section (6) may, within thirty days from the date of communication to it or to him of the order, prefer an appeal to the Central Government and the decision of the Central Government thereon, and subject thereto, the order made by the Reserve Bank under sub-section (6), shall be final and shall not be called into question in any Court.

(8) Notwithstanding anything contained in this section, the Reserve Bank may, if in its opinion it is necessary in the public interest so to do, permit the Chairman of the Board of Directors who is appointed on a whole-time basis or the Managing Director) to undertake such part-time honorary work as is not likely to interfere with his duties as such Chairman or managing director.

(9) Notwithstanding anything contained in this section, where a person appointed on a whole-time basis, as Chairman of the Board of Directors or Managing Director dies or resigns or is by infirmity or otherwise rendered incapable of carrying out his duties or is absent on leave or otherwise in circumstances not involving the vacation of his office, the banking company may, with the approval of the Reserve Bank, make suitable arrangements for carrying out the duties of Chairman or Managing Director for a total period not exceeding four months.

Power of Reserve Bank to appoint Chairman of a banking company: Section 10BB of BR Act provides that:

(1) Where the office of the Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director of a banking company is vacant, the Reserve Bank may, if it is of opinion that the continuation of such vacancy is likely to adversely affect the interest of the banking company, appoint a person, eligible under sub-section (4) of Sec. 10-B to be so appointed, to be the Chairman of the banking company and where the person so appointed is not a director of such banking company, he shall, so long as he holds the office of the Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director, be deemed to be a director of the banking company.

(2) The Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director so appointed by the Reserve Bank shall be in the whole-time employment of the banking company and shall hold office for such period not exceeding three years, as the Reserve Bank may specify, but shall, subject to other provisions of this Act, be eligible to re-appointment.
(3) The Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director, so appointed by the Reserve Bank shall draw from the banking company such pay and allowances as the Reserve Bank may determine and may be removed from office only by the Reserve Bank.

(4) Save as otherwise provided in this section, the provisions of Sec. 10-B shall, as far as may be, apply to the Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director appointed by the Reserve Bank under sub-section (1) as they apply to the Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director appointed by the banking company.

Chairman and certain directors not to be required to hold qualification shares: Section 10 C of the BR Act provides that Chairman of the Board of Directors who is appointed on a whole-time basis or a Managing Director of a banking company by whomsoever appointed and a director of a banking company (appointed by the Reserve Bank under Sec. 10-A shall not be required to hold qualification shares in the banking company.

(D) SEBI’s (LODR) Regulations, 2015: Many of banking companies are listed with the stock exchanges. The banks listed with the stock exchange have to adhere to the requirement of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Thus, we have seen that the banking companies are governed by the BR Act, have to follow the directions of the RBI, Special Act under which they have been incorporated or under the Companies act and if listed with the stock exchange, have to adhere with the listing requirements too, except where the provisions are not in conformity with directives of Reserve Bank of India or the Act as applicable to a respective bank.

GANGULY COMMITTEE RECOMMENDATIONS ON CORPORATE GOVERNANCE IN BANKS

The RBI vide its circular number DBOD. No. BC.-116/08.139.001/2001-02 dated 20th June 2002, circulated to all scheduled commercial banks, a Report of the Consultative Group of Directors of Banks/Financial Institutions (Dr. Ganguly Group) - Implementation of recommendations. The RBI through this circular urged the banks to place the Report as well as the list of recommendations enclosed in circular before the Board of Directors of respective banks. Based on the decision taken by the Board, these recommendations be adopted and implemented in banks.

The list of the recommendations is as under:

Recommendations which may be implemented by all banks:

(i) Responsibilities of the Board of Directors:

   (a) A strong corporate board should fulfil the following four major roles viz. overseeing the risk profile of the bank, monitoring the integrity of its business and control mechanisms, ensuring the expert management, and maximising the interests of its stakeholders.

   (b) The Board of Directors should ensure that responsibilities of directors are well defined and every director should be familiarised on the functioning of the bank before his induction, covering the following essential areas:

      - delegation of powers to various authorities by the Board,
      - strategic plan of the institution
      - organisational structure
financial and other controls and systems
• economic features of the market and competitive environment.

(ii) Role and responsibility of independent and non-executive directors:

(a) The independent/non-executive directors have a prominent role in inducting and sustaining a pro-active governance framework in banks.

(b) In order to familiarise the independent /non-executive directors with the environment of the bank, banks may circulate among the new directors a brief note on the profile of the bank, the sub committees of the Board, their role, details on delegation of powers, the profiles of the top executives etc.

(c) It would be desirable for the banks to take an undertaking from each independent and non-executive director to the effect that he/she has gone through the guidelines defining the role and responsibilities and enter into covenant to discharge his/her responsibilities to the best of their abilities, individually and collectively.

(iii) Training facilities for directors:

(a) Need-based training programmes/seminars/workshops may be designed by banks to acquaint their directors with emerging developments/challenges facing the banking sector and participation in such programmes could make the directors more sensitive to their role.

(b) The Board should ensure that the directors are exposed to the latest managerial techniques, technological developments in banks, and financial markets, risk management systems etc. so as to discharge their duties to the best of their abilities.

(c) While RBI can offer certain training programmes/seminars in this regard at its training establishments, large banks may conduct such programmes in their own training centres.

(iv) Submission of routine information to the Board: Reviews dealing with various performance areas may be put up to the Management Committee of the Board and only a summary on each of the reviews may be put up to the Board of directors at periodic intervals. This will provide the Board more time to concentrate on more strategic issues such as risk profile, internal control systems, overall performance of the bank, etc.

(v) Agenda and minutes of the board meeting:

(a) The draft minutes of the meeting should be forwarded to the directors, preferably via the electronic media, within 48 hours of the meeting and ratification obtained from the directors within a definite time frame. The directors may be provided with necessary technology assistance towards this end.

(b) The Board should review the status of the action taken on points arising from the earlier meetings till action is completed to the satisfaction of the Board, and any pending item should be continued to be put up as part of the agenda items before the Board.

(vi) Committees of the Board:

(a) Shareholders’ Redressal Committee: As communicated to banks vide circular DBOD No.111/08.138.001/2001-02 dated June 4, 2002 on SEBI Committee on Corporate Governance, the banks which have issued shares/debentures to public may form a committee under the chairmanship of a non-executive director to look into redressal of shareholders’ complaints.

(b) Risk Management Committee: In pursuance of the Risk Management Guidelines issued by the Reserve Bank of India in October 1999, every banking organisation is required to set up Risk
Management Committee. The formation and operationalisation of such committee should be speeded up and their role further strengthened.

(c) **Supervisory Committee:** The role and responsibilities of the Supervisory Committee as envisaged by the Group viz., monitoring of the exposures (both credit and investment) of the bank, review of the adequacy of the risk management process and upgradation thereof, internal control system, ensuring compliance with the statutory/regulatory framework etc., may be assigned to the Management Committee/Executive Committee of the Board.

(vii) **Disclosure and transparency**

The following disclosures should be made by banks to the Board of Directors at regular intervals as may be prescribed by the Board in this regard.

- progress made in putting in place a progressive risk management system, and risk management policy and strategy followed by the bank.
- exposures to related entities of the bank, viz. details of lending to/investment in subsidiaries, the asset classification of such lending/investment, etc.
- conformity with corporate governance standards viz. in composition of various committees, their role and functions, periodicity of the meetings and compliance with coverage and review functions etc.

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<th>Recommendations applicable only to public sector bank</th>
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(i) **Information flow:** In order to improve manner in which the proceedings are recorded and followed up in public sector banks, they may initiate measures to provide the following information to the board:

- A summary of key observations made by the directors which should be submitted in the next board meeting.
- A more detailed recording of the proceedings which will clearly bring out the observations, dissents, etc. by the individual directors which could be forwarded to them for their confirmation.

(ii) **Company Secretary:** The Company Secretary has important fiduciary and Company Law responsibilities. The Company Secretary is the nodal point for the Board to get feedback on the status of compliance by the organisation in regard to provisions of the Company Law, listing agreements, SEBI regulations, shareholder grievances, etc. In view of the important role performed by the Company Secretary vis-à-vis the functioning of the Boards of the banks, as also in the context of some of the public sector banks having made public issue it may be necessary to have Company Secretary for these banks also. Banks should therefore consider appointing qualified Company Secretary as the Secretary to the Board and have a Compliance Officer (reporting to the Secretary) for ensuring compliance with various regulatory/accounting requirements.

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<th>Recommendations applicable only to private sector bank</th>
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(i) **Eligibility criteria and ‘fit and proper’ norms for nomination of directors:**

(a) The Board of Directors of the banks while nominating/ co-opting directors should be guided by certain broad ‘fit and proper’ norms for directors, viz. formal qualification, experience, track record, integrity etc. For assessing integrity and suitability features like criminal records, financial position, civil actions initiated to pursue personal debts, refusal of admission to or expulsion from professional bodies, sanctions applied by regulators or similar bodies, previous questionable
business practices etc should be considered. The Board of Directors may, therefore, evolve appropriate systems for ensuring ‘fit and proper’ norms for directors, which may include calling for information by way of self-declaration, verification reports from market, etc.

(b) The following criteria, which is in vogue in respect of nomination to the boards of public sector banks, may also be followed for nominating independent/ non-executive directors on private sector banks:

- The candidate should normally be a graduate (which can be relaxed while selecting directors for the categories of farmers, depositors, artisans, etc.)
- He/she should be between 35 and 65 years of age.
- He/she should not be a Member of Parliament/Member of Legislative Assembly/ Member of Legislative Council.

(ii) Commonality of directors of banks and non banking finance companies (NBFC): In case, a director on the board of an NBFC is to be considered for appointment as director on the board of the bank, the following conditions must be followed:

- He/she is not the owner of the NBFC, [i.e., share holdings (single or jointly with relatives, associates, etc.) should not exceed 50%],
- He/she is not related to the promoter of the NBFC,
- He/she is not a full-time employee in the NBFC.
- The concerned NBFC is not a borrower of the bank.

(iii) Composition of the Board: In the context of banking becoming more complex and competitive, the composition of the Board should be commensurate with the business needs of the banks. There is an urgent need for making the Boards of banks more contemporarily professional by inducting technical and specially qualified personnel. Efforts should be aimed at bringing about a blend of 'historical skills' set, i.e. regulation based representation of sectors like agriculture, SSI, cooperation etc. and the 'new skills' set, i.e. need based representation of skills such as, marketing, technology and systems, risk management, strategic planning, treasury operations, credit recovery etc. The above suggestions may be kept in view while electing/co-opting directors to their boards.

**BASEL COMMITTEE ON CORPORATE GOVERNANCE**

Banks are the custodians of the public money. The objective of the Corporate Governance in banks is first the protections of the depositor’s interest and then to optimise the share holders/ stake holders interest.

**Basel I:** The Bank for International Settlement based Basel Committee on Banking Supervision in 1988 brought out the regulations relating to the capital requirements for banks. After the collapse of the certain hedge funds in New York and threatening to the banking system in the US, India adopted the Basel-I norms in 1992, the time when the economic reforms is said to have begun. Basel committee in Sept 1999 published a paper on Corporate Governance for banking organisations. The committee felt that it was the responsibility of the banking supervisors to ensure that there was effective corporate governance in the banking industry.

**Basel II:** The original Basel accord was found to have some deficiencies and to remove it, the first version of the Basel II came out in 1999 and after widely debate, it finally came out in June 2004. The Basel II rests on three pillars and the overall goal of it was to promote adequate capitalisation of banks and to encourage improvements in risk management and strengthening the stability of the financial system.
**Basel III**: Basel Committee on Banking Supervision (BCBS) released comprehensive reform package entitled “Basel III: A global regulatory framework for more resilient banks and banking systems” (known as Basel III capital regulations) in December 2010, which was revised in June 2011. Basel III reforms strengthen the bank-level i.e. micro prudential regulation, with the intention to raise the resilience of individual banking institutions in periods of stress. Besides, the reforms have a macro prudential focus also, addressing system wide risks, which can build up across the banking sector, as well as the procyclical amplification of these risks over time. Reserve Bank issued Guidelines based on the Basel III reforms on capital regulation on May 2, 2012, to the extent applicable to banks operating in India. The Basel III capital regulation has been implemented from April 1, 2013 in India in phases and it will be fully implemented as on March 31, 2019. In 2017, the Committee finalised Basel III reforms, which addresses a number of shortcomings with the pre-crisis regulatory framework and provides a regulatory foundation for a resilient banking system that supports the real economy.

Guidelines on Corporate Governance for banks were released by the Basel Committee on Banking Supervision in July 2015.

The principles of corporate governance of these guidelines are as under:

- **Principle 1: Board’s overall responsibilities**: The board has overall responsibility for the bank, including approving and overseeing the implementation of the bank’s strategic objectives, governance framework and corporate culture. The board is also responsible for providing oversight of senior management.

- **Principle 2: Board qualifications and composition**: Board members should be and remain qualified, individually and collectively, for their positions. They should understand their oversight and corporate governance role and be able to exercise sound, objective judgment about the affairs of the bank.

- **Principle 3: Board’s own structure and practices**: The board should define appropriate governance structures and practices for its own work, and put in place the means for such practices to be followed and periodically reviewed for ongoing effectiveness.

- **Principle 4: Senior management**: Under the direction and oversight of the board, senior management should carry out and manage the bank’s activities in a manner consistent with the business strategy, risk appetite, remuneration and other policies approved by the board.

- **Principle 5: Governance of group structures**: In a group structure, the board of the parent company has the overall responsibility for the group and for ensuring the establishment and operation of a clear governance framework appropriate to the structure, business and risks of the group and its entities. The board and senior management should know and understand the bank group’s operational structure and the risks that it poses.

- **Principle 6: Risk management function**: Banks should have an effective independent risk management function, under the direction of a chief risk officer (CRO), with sufficient stature, independence, resources and access to the board.

- **Principle 7: Risk identification, monitoring and controlling**: Risks should be identified, monitored and controlled on an ongoing bank-wide and individual entity basis. The sophistication of the bank’s risk management and internal control infrastructure should keep pace with changes to the bank’s risk profile, to the external risk landscape and in industry practice.

- **Principle 8: Risk communication**: An effective risk governance framework requires robust
communication within the bank about risk, both across the organisation and through reporting to the board and senior management.

- **Principle 9: Compliance**: The bank’s board of directors is responsible for overseeing the management of the bank’s compliance risk. The board should approve the bank’s compliance approach and policies, including the establishment of a permanent compliance function.

- **Principle 10: Internal audit**: The internal audit function provides independent assurance to the board and supports board and senior management in promoting an effective governance process and the long-term soundness of the bank. The internal audit function should have a clear mandate, be accountable to the board, be independent of the audited activities and have sufficient standing, skills, resources and authority within the bank.

- **Principle 11: Compensation**: The bank’s compensation structure should be effectively aligned with sound risk management and should promote long term health of the organisation and appropriate risk-taking behavior.

- **Principle 12: Disclosure and transparency**: The governance of the bank should be adequately transparent to its shareholders, depositors, other relevant stakeholders and market participants.

- **Principle 13: The role of supervisors**: Supervisors should provide guidance for and supervise corporate governance at banks, including through comprehensive evaluations and regular interaction with boards and senior management, should require improvement and remedial action as necessary, and should share information on corporate governance with other supervisors.

[Note: For detailed study on this aspect, the students may refer to https://www.bis.org/publ/bcbs294.pdf]

### CORPORATE GOVERNANCE DEVELOPMENTS IN BANKS

With a view to strengthen corporate governance, over a period of time, various guidelines have been issued in matters relating to the role to be played by the Board, fit and proper criteria for the directors of banks, bifurcation of the post of Chairman and Managing Director (CMD), remuneration etc.

Recognising that ownership of banks by one or few individuals could be detrimental to the public interest, especially, depositors’ interests, it is stipulated that, in India, banks should have a diversified ownership model. To ensure that ownership and control of banks are well diversified, guidelines on ownership and governance in private sector banks were issued by the Reserve Bank in 2005. Another important regulatory prescription in this regard is the requirement of Reserve Bank’s prior approval for any acquisition of shares in private sector banks resulting in a shareholding of 5 per cent or more of the total paid up capital of the bank.

The importance of diversified ownership is also underlined in the recent guidelines on new bank licenses wherein it is stipulated that Non-Operative Financial Holding Companies (NOFHC) which set up new banks should, after the initial lock in period of five years, bring down their equity capital of the bank from the minimum 40% while setting up to 15% within 12 years. To ensure ‘Fit and Proper’ status of the groups that would set up new banks, it is also stipulated that entities / groups should have a past record of sound credentials and integrity, be financially sound with a successful track record of 10 years.

### CORPORATE GOVERNANCE OF NON-BANKING FINANCE COMPANIES (NBFCs)

Traditionally, Non-Banking Finance Companies (NBFCs) in India were small family run businesses some of which accepted deposits and engaged mainly in activities such as lending. Over the years, the NBFC sector has not only grown in size but also in terms of interconnectedness and systemic importance. Today, the sector has a total asset size constituting just above 12% of that of scheduled commercial banks, some of the
NBFCs have grown very big and are operating as conglomerates with business interests spread across insurance, broking, mutual fund, real estate etc.

Keeping in mind the growing significance of NBFCs in the financial system and their interconnectedness with the banking sector, there is a strong case for strengthening their governance framework so as not only to protect the individual institutions and their depositors, but also to ensure the stability of the entire financial system. Further, NBFCs have exposures to sensitive sectors such as real estate and capital markets and they also rely on wholesale funding, all of which point to the requirement of robust internal controls and governance framework to ensure their stability.

The Reserve Bank of India vide its circular No. BI/2014-15/299 DNBR (PD) CC. No. 002/03.10.001/2014-15 dated November 10, 2014 addressed to all NBFCs (excluding Primary Dealers) issued Revised Regulatory Framework for NBFC.

Para 9 of the said circular which deals with the Corporate Governance and Disclosure norms for NBFCs provides as under:

9.1 The need for adoption of good corporate governance practices continues to engage the regulator and stakeholder attention. In this connection, in continuation of previous circulars on Corporate Governance, certain amendments to the Corporate Governance guidelines are made as given below.

9.2 In terms of the above mentioned circulars, NBFCs-D with deposits of Rs. 20 crore and above, and NBFCs-ND with asset size of Rs. 50 crore and above are required to constitute an Audit Committee; NBFCs-D with deposits of Rs. 20 crore and above, and NBFCs-ND with assets of Rs. 100 crore and above are advised to consider constituting Nomination Committee to ensure ‘fit and proper’ status of proposed/existing Directors and Risk Management Committee. Further, NBFCs-D with deposits of Rs. 50 crore and above were advised that it was desirable that they stipulate rotation of partners of audit firms appointed for auditing the company every three years.

**Board Committees**

9.3 As part of harmonisation, the constitution of the three Committees of the Board and instructions with regard to rotation of partners have now been made applicable to all NBFCs-ND-SI, as also all NBFCs-D. Other NBFCs are encouraged to observe such practices, if already being followed.

9.4 In addition, the Audit Committee of all NBFCs-ND-SI, as also all NBFCs-D must ensure that an Information Systems Audit of the internal systems and processes is conducted at least once in two years to assess operational risks faced by the company.

**Fit and Proper Criteria for Directors**

9.5 With the increasing integration of NBFCs in the financial sector and their growing systemic significance, it has become important that the Directors and shareholders who are responsible for steering the affairs of the companies are fit and proper, besides having the necessary qualifications. In view of this, the following additional requirements are being put in place, which shall be applicable to all NBFCs-ND-SI, as also all NBFCs-D, with effect from March 31, 2015.

(i) NBFCs shall ensure that there is a policy put in place for ascertaining the fit and proper criteria at the time of appointment of Directors and on a continuing basis. The policy on the fit and proper criteria should be on the lines of the Guidelines.

(ii) A declaration and undertaking shall be obtained from the Directors by the NBFC.
(iii) In addition, the Directors shall sign a Deed of Covenant.

(iv) NBFCs shall furnish to the Reserve Bank a quarterly statement on change of Directors certified by
the auditors and a certificate from the Managing Director that fit and proper criteria in selection of
directors have been followed. The statement must reach the Regional Office concerned of the
Reserve Bank within 15 days of the close of the quarter.

Disclosures in Financial Statements – Notes to Account

9.6 A reference is invited to under which NBFCs with assets of Rs. 100 crore and above were required to
make additional disclosures in their balance sheets from the year ending March 31, 2009 relating to CRAR, exposure to real estate sector (both direct and indirect), and maturity pattern of assets and liabilities
respectively. The above disclosures are now applicable for NBFCs-ND-SI (as redefined) and for all NBFCs-
D. However, other NBFCs already disclosing the above are encouraged to continue to do so, in line with prudent practice.

9.7 The extant disclosures are however far from comprehensive. There is need for greater transparency to
provide enhanced information to the market and retain stakeholder confidence. It has hence been decided
that in addition to the above disclosures, all NBFCs-ND-SI (as redefined), as also all NBFCs-D shall
additionally disclose the following in their Annual Financial Statements, with effect from March 31, 2015:

(i) Registration/ licence/ authorisation obtained from other financial sector regulators;
(ii) Ratings assigned by credit rating agencies and migration of ratings during the year;
(iii) Penalties, if any, levied by any regulator;
(iv) Information viz., area, country of operation and joint venture partners with regard to Joint Ventures and Overseas Subsidiaries; and
(v) Asset liability profile, extent of financing of parent company products, NPAs and movement of NPAs, details of all off-balance sheet exposures, structured products issued by them as also securitization/ assignment transactions and other disclosures.

CORPORATE GOVERNANCE GUIDELINES FOR INSURANCE COMPANIES

The Authority had initially issued Guidelines on Corporate Governance for insurance companies vide circular dated 5th August, 2009. The Authority had also issued separate guidelines for appointment/ reappointment and remuneration of MD/CEO/ WTD as well as other Key Management Persons (KMPs), as also the Appointment of statutory auditors of insurers through various circulars.

The Insurance Regulatory and Development Authority of India (IRDAI) has revised the existing Guidelines in the light of changes brought in by the Companies Act, 2013 vide Circular Dated 18th May 2016.

The objective of the guidelines is to ensure that the structure, responsibilities and functions of Board of Directors and the management of the company recognize the expectations of all stakeholders as well as those of the regulator.

The guidelines address the various requirements broadly covering the following major structural elements of Corporate Governance in insurance companies:

1. Governance structure
2. Board of Directors
3. CEO
4. Key Management functions
5. Role of Appointed Actuaries
6. External audit – Appointment of Statutory Auditors
7. Disclosures
8. Relationship with stakeholders
9. Interaction with the Supervisor
10. Whistle blower policy

These guidelines shall be applicable to all insurers granted registration by the Authority except that:

(i) reinsurance companies may not be required to have the Policyholders’ Protection Committee; and

(ii) branches of foreign reinsurers in India may not be required to constitute the Board and its mandatory committees as indicated herein.

1. Governance Structure

The insurance companies presently could have different structures with the Board of Directors headed by an Executive or Non-executive Chairman with distinct oversight responsibilities over the other Directors and Key Management Persons. It is expected that whatever form is taken, the broader elements of good Corporate Governance are present.

The governance structure of the insurer could also be influenced by its association with an insurance group or a larger financial/ non-financial conglomerate. Insurers who are a part of a financial group could also be subject to the regulatory requirements on governance policies and practices established for the group level and implemented uniformly across the group.

However, these practices should be reoriented at the level of the insurer taking into account its specific business and risk profile and sectoral regulatory requirements. Such insurers should nevertheless strive to maintain consistency in policies and practices in order to reinforce controls across the group.

2. Board of Directors

(a) Composition

• The Insurance Act stipulates that the insurance companies in India would be public companies and hence, would require a properly constituted Board.

• Insurance companies should ensure that the Board comprises of competent and qualified Directors to drive the strategies in a manner that would sustain growth and protect the interests of the stakeholders in general and policyholders in particular.

• The size of the Board in addition to being compliant with legal requirements (where applicable), should be consistent with scale, nature and complexity of business.

• It is expected that the shareholders of the companies elect or nominate Directors from various areas of financial and management expertise such as accountancy, law, insurance, pension, banking, securities, economics, etc., with qualifications and experience that is appropriate to the company.

• It is essential that the Directors possess the knowledge of group structure, organizational structure, process and products of the insurer and the Board generally complies with the following requirements:-
The Board of Directors and Key Management Persons should understand the operational structure of the insurer and have a general understanding of the lines of business and products of the insurer, more particularly as the insurer grows in size and complexity.

The Board of Directors of an insurer belonging to a larger group structure/ conglomerate should understand the material risks and issues that could affect the group entities, with attendant implication on the insurer.

- The Board of Directors is required to have a minimum of three “Independent Directors”. However, this requirement is relaxed to ‘two’ independent directors, for the initial five years from grant of Certificate of Registration to insurers. An independent Director shall fulfill all the conditions specified under Section 149 of the Companies Act, 2013.

In case the number of independent directors falls below the required minimum laid down, such vacancy shall be filled up before the immediately following Board meeting or 3 months from the date of such vacancy, whichever is later, under intimation to the Authority.

- Where the Chairman of the Board is non-executive, the Chief Executive Officer should be a whole time director of the Board.

- As required under Section 149 of the Companies Act, 2013, there shall be at least one Woman Director on the Board of every Insurance company.

(b) The Role and responsibility of the Board

The specific areas of responsibilities of the Board of insurers are provided as under-

1. The Board should ensure that the Governance principles set for the insurer comply with all relevant laws, regulations and other applicable codes of conduct.

2. The Board should set the following policies in consultation with the Management of the Company.
   (a) Define and periodically review the business strategy.
   (b) Define the underwriting policy of the insurer.
   (c) Determine the retention and reinsurance policy and in particular, the levels of retentions of risk by the insurer and the nature and extent of reinsurance protection to be maintained by the insurer.
   (d) Define the policy of the insurer as regards investment of its assets consistent with an appropriate asset liability management structure.
   (e) Define the insurer’s policy on appointments and qualification requirements for human resources and ensure that the incentive structure does not encourage imprudent behaviour.

3. The Board should define and set the following standards:-
   (a) Define the standards of business conduct and ethical behaviour for directors and senior management.
   (b) Define the standards to be maintained in policyholder servicing and in redressal of grievances of policyholders.

4. The Board would be responsible to provide guidance for implementation of business strategy and review the same periodically.
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(5) As an integral part of proper implementation of the business strategy, the Board should take action as under:

(a) Establish appropriate systems to regulate the risk appetite and risk profile of the Company. It will also enable identification and measurement of significant risks to which the company is exposed in order to develop an effective risk management system.

(b) Ensure that all directions of IRDAI are submitted to the Board and the recommendations are implemented as per the Board philosophy.

(c) Ensure that the IT systems in the company are appropriate and have built-in checks and balances to produce data with integrity and put in place a business continuity and disaster recovery plan.

(d) Ensure that the company has put in place a robust compliance system for all applicable laws and regulations.

(e) Prescribe requirements and frequency of reporting in respect of each of the above areas of responsibility as may be decided by the Board.

(6) In discharge of the above and other Governance functions, the Board may delegate the responsibilities to mandated/other recommended Empowered Committees of Directors while retaining its primary accountability.

(c) Eligibility Criteria

The Directors of insurers have to meet the “fit and proper” criteria. Currently, the fit and proper requirements seek to ensure that the Director should not have been convicted or come under adverse notice of the laws and regulations involving moral turpitude or of any professional body.

(d) Disclosures about Meetings of the Board and its Committees

Insurers shall ensure compliance with the provisions of the Companies Act, 2013 and the Secretarial Standards issued by the ICSI from time to time as regards conduct of the meetings of the Board of Directors and their committees. In addition to the above, all insurers shall disclose the following in the Director’s Report:

- Number of meetings of the Board of Directors and Committees mandated under these Guidelines, in the financial year
- Details of the composition of the Board of Directors and Committees mandated, setting out name, qualification, field of specialization, status of directorship held etc.
- Number of meetings attended by the Directors and members of the Committee
- Details of the remuneration paid, if any, to all directors (including Independent Directors)

(e) Control Functions

Given the risks that an insurer takes in carrying out its operations, and the potential impact it has on its business, it is important that the Board lays down the policy framework to put in place:

- robust and efficient mechanisms for the identification, assessment, quantification, control, mitigation and monitoring of the risks;
- appropriate processes for ensuring compliance with the Board approved policy, and applicable laws and
regulations;

- appropriate internal controls to ensure that the risk management and compliance policies are observed;
- an internal audit function capable of reviewing and assessing the adequacy and effectiveness of, and the insurer’s adherence to its internal controls as well as reporting on its strategies, policies and procedures; and
- Independence of the control functions, including the risk management function, from business operations demonstrated by a credible reporting arrangement.

(f) Delegation of Functions- Committees of the Board:

With a view to providing adequate Board time for discharge of the significant corporate responsibilities, the Board can consider setting up of various Committees of Directors by delegating the overall monitoring responsibilities after laying down the roles and responsibilities of these Committees to the Board.

Insurers may establish several Committees to undertake specific functions depending on the size and level of the complexity of the operations. Typically, the Committees that assist the Board are Audit Committee, Risk Management Committee, Nomination and Remuneration Committee, Investment Committee, Ethics Committee and Asset-Liability Management Committee.

However, the Authority advises all insurers that it is mandatory to establish Committees for Audit, Investment, Risk Management, Policyholder Protection, Nomination and Remuneration, Corporate Social Responsibility (only for insurers earning profits).

In addition, Regulation 45d of the IRDA (Non-linked Insurance Products) Regulations, 2013 requires constitution of a ‘With Profits’ Committee by Life Insurance Companies comprising of one Independent Director of the Board, the Chief Executive Officer, the Appointed Actuary of the Company and an Independent Actuary. Establishment of the other Committees is left to the option of the insurer.

(i) Audit Committee (mandatory)

Every Insurer shall constitute an Audit Committee as per Section 177 of the Companies Act, 2013 and will play role provided as provided under the Act. As required under Section 177 of the Companies Act, 2013, the Audit Committee shall comprise of a minimum of three directors, majority of whom shall be Independent Directors.

(ii) Investment Committee (mandatory)

The Board of every Insurer shall set up an Investment Committee comprising of at least two Non-Executive Directors, the Chief Executive Officer, Chief of Finance, Chief of Investment, Chief Risk Officer and, the Appointed Actuary. The Committee shall be responsible to recommend investment policy and lay down the operational framework for the investment operations of the insurer. The policy should focus on a prudential Asset Liability Management (ALM) supported by robust internal control systems. The investment policy and operational framework should, inter alia, encompass aspects concerning liquidity for smooth operations, compliance with prudential regulatory norms on investments, risk management / mitigation strategies to ensure commensurate yield on investments and above all protection of policyholders’ funds.

(iii) Risk Management Committee (mandatory)

It is now well recognized that the sound management of insurance in pursuit of development of a strong risk management system and mitigation strategies, insurers shall set up a separate Risk Management Committee to implement the company’s Risk Management Strategy. The risk management function should
be under the overall guidance and supervision of the Chief Risk Officer (CRO) with a clearly defined role. It shall be organized in such a way that it is able to monitor all the risks across the various lines of business of the company and the operating head has direct access to the Board.

(iv) Policyholder Protection Committee (mandatory)

The Authority is mandated by statute to protect policyholders’ interests and therefore adoption of sound and healthy market practices in terms of sales, marketing, advertisements, promotion, publicity, redressal of customer grievances, consumer awareness and education is essential. The Authority has, therefore, notified various Regulations/Guidelines/Circulars in this regard.

With a view to addressing the various compliance issues relating to protection of the interests of policyholders, as also relating to keeping the policyholders well informed of and educated about insurance products and complaint-handling procedures, each insurer shall set up a Policyholder Protection Committee.

Such Committee shall be headed by a Non-Executive Director and shall include an expert/representative of customers as an invitee to enable insurers to formulate policies and assess compliance thereof.

(v) Nomination and Remuneration Committee (mandatory)

The Nomination and Remuneration Committee shall be constituted in line with the provisions of Section 178 of the Companies Act, 2013. Indian Insurance Companies which have constituted two independent committees for Nomination and Remuneration separately may merge these two Committees after seeking the Board approval, under intimation to the Authority, within a period of 180 days from the date of issue of these guidelines.

It is pertinent to draw attention to the provisions of Section 34 (A) (1) of the Insurance Act, 1938 which stipulates that the remuneration of CEOs/Whole-time Directors of Indian insurance companies is subject to statutory approval of the IRDAI. Further, the overall management costs of the insurer are also additionally governed by the limits prescribed statutorily in the Insurance Act and Regulations framed there under in order to protect the interests of the policyholders. The setting up of a Nomination and Remuneration Committee should keep the above requirements in view.

(vi) Corporate Social Responsibility Committee (‘CSR Committee’) (mandatory)

Section 135 of the Companies Act, 2013 requires constitution of a CSR Committee if certain conditions as mentioned in the said Section are fulfilled. For Indian Insurance Companies, a CSR Committee is required to be set up if the insurance company earns a Net Profit of Rs. 5 Crores or more during the preceding financial year.

In line with Section 135(5) of Companies Act, 2013, the Board of Directors of the Company shall ensure that the Company spends not less than 2% of the three years’ average Net Profits as defined above towards the CSR activities.

(vii) With Profits Committee:

The Authority has issued IRDA (Non-Linked Insurance Products) Regulations 2013, which lay down the framework about the With Profit Fund Management and Asset sharing, among other things. In terms of these Regulations, every Insurer transacting life insurance business shall constitute a With Profits Committee comprising of an Independent Director, the CEO, The Appointed Actuary and an independent Actuary. The Committee shall meet as often as is required to transact the business and carry out the functions of
determining the following:

- the share of assets attributable to the policyholders
- the investment income attributable to the participating fund of policyholders
- the expenses allocated to the policyholders

The report of the With Profits Committee in respect of the above matters should be attached to the Actuarial Report and Abstract furnished by the insurers to the Authority.

(8) Other Committees

The other Committees which can be set up by the Board, include the Ethics Committee and ALM Committee (other than life insurers). In cases where Board decides not to constitute such Committees, their functions and responsibilities can be addressed in such manner as the Board may deem fit.

3. CEO/ Managing Director/ Whole-Time Director

The Chief Executive Officer/Whole Time Director/ Managing Director of the company and other key functionaries are responsible for the operations and day to day management of the company in line with the directions of the Board and the Committees set up by the Board. Section 34A of the Insurance Act, 1938 requires prior approval of the Authority for appointment, re-appointment or termination of the Chief Executive Officer and the Whole Time Directors. The Authority expects the CEO to be responsible for the conduct of the company’s affairs in a manner which is not detrimental to the interests of the policyholders and which is consistent with the policies and directions of the Board.

Role of Appointed Actuaries

IRDAI has brought out detailed Regulations on Appointed Actuary vide IRDA (Appointed Actuary) Regulations, 2000, detailing the procedure for his appointment, qualifications, powers along with his duties and obligations. The Regulations also stipulate that prior approval of the Authority shall be taken for the appointment of the Appointed Actuary. The Board should ensure that the requirements are scrupulously complied with. In brief, it is reiterated that:

- A procedure for appointment of Appointed Actuary should be put in place.
- The Appointed Actuary should qualify and satisfy the ‘Fit & Proper’ criteria and other eligibility conditions as mentioned in IRDA (Appointed Actuary) Regulations, 2000, as amended from time to time.
- The insurance companies shall clearly set forth the Appointed Actuary’s responsibilities and any advisory role vis-à-vis the Board or the management as well as his/her rights and obligations. These shall be in addition to the duties of the Appointed Actuaries as specified in the IRDA Regulations and any other directions of IRDA in the matter.
- As soon as the Appointed Actuary realizes that the entity does not comply or is likely to fail in complying with the requirements of solvency and other parameters of sound operations, he/she shall inform the Board of the insurer. If no viable/acceptable action is taken by the Board, then he/she has to inform the same to IRDAI.
- The Board shall interact directly with the Appointed Actuary wherever it considers it expedient to secure his advice, it may do so in such manner as it may deem fit. The Appointed Actuary shall provide professional advice or certification to the board with regard to:-
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○ Estimation of technical provisions in accordance with the valuation framework set up by the insurer
○ Identification and estimation of material risks and appropriate management of the risks
○ Financial condition testing
○ Solvency margin requirements
○ Appropriateness of premiums (and surrender value)
○ Allocation of bonuses to with-profit insurance contracts
○ Management of participating funds (including analysis of material effects caused by strategies and policies)
○ Product design, risk mitigation (including reinsurance) and other related risk management roles.

While the areas of advice/certification listed above are with specific reference to life companies, the appointed actuaries in case of non life insurance companies shall provide such advice/certification to the extent applicable. In order to facilitate the Appointed Actuary in discharging his/her responsibilities, he/she shall at all times be provided access to the information as required.

8A. External Audit - Appointment of Statutory Auditors

The IRDAI (Preparation of Financial Statements and Auditors’ Report of Insurance Companies) Regulations, 2002 empower the Authority to issue directions/guidelines on appointment, continuance or removal of auditors of an insurer. These guidelines/directions may include prescriptions on qualifications and experience of auditors, their rotation, period of appointment, etc. as may be deemed necessary by the Authority.

The detailed guidelines as regards appointment of auditors and the reporting about all the auditors appointed by insurers are given in Annexure 7 to these guidelines. The Board should therefore ensure that the statutory auditors are compliant with the regulatory requirements and there are no conflicts of interest in their appointment. The auditors should possess the competence and integrity to alert the appropriate authorities promptly of any event that could seriously affect the insurance company's financial position or the organization structure of its administration or accounting and of any criminal violations or material irregularities that come to his notice.

8A.1 Access to Board and Audit Committee

The Audit Committee should have discussions with the statutory auditors periodically about internal control systems, the scope of audit including the observations of the auditors (where applicable) and review the quarterly/half yearly and annual financial statements as the case may be before submission to the Board of Directors and also ensure compliance with the internal control systems. The statutory auditors should also have access to the Board of Directors through the Audit Committee.

9. Disclosure Requirements

The IRDAI (Preparation of Financial Statements and Auditors’ Report of Insurance Companies) Regulations, 2002, have prescribed certain disclosures in the financial statements and the Authority is in the process of finalizing additional disclosures to be made by insurers at periodical intervals. In the meantime, it may be ensured by the Board that the information on the following, including the basis, methods and assumptions on which the information is prepared and the impact of any changes therein are also disclosed in the annual accounts:

- Quantitative and qualitative information on the insurance company's financial and operating ratios, viz. incurred claim, commission and expenses ratios.
• Actual solvency margin details vis-à-vis the required margin
• Insurers engaged in life insurance business shall disclose persistency ratio of policies sold by them
• Financial performance including growth rate and current financial position of the insurance company
• Description of the risk management architecture
• Details of number of claims intimated, disposed off and pending with details of duration
• All pecuniary relationships or transactions of the Non-Executive Directors vis-à-vis the insurance company shall be disclosed in the Annual Report
• Elements of remuneration package (including incentives) of MD & CEO and all other directors and Key Management Persons
• Payments made to group entities from the Policyholders Funds
• Any other matters, which have material impact on the insurer’s financial position.

Where finalization of annual accounts extends beyond 90 days from the end of the Financial Year, the status on disclosure in the financial statements required under this clause may be made within 15 days of adoption of annual accounts by the Board of Directors of the Insurers.

10. Outsourcing Arrangements

10.1 All outsourcing arrangements of an Insurer shall have the approval of a Committee of Key Management Persons and should meet the terms of the Board approved outsourcing policy. The Board or the Risk Management Committee should be periodically apprised about the outsourcing arrangements entered into by the insurer and also confirmation to the effect that they comply with the stipulations of the Authority as well as the internal policy be placed before them. An insurer shall not outsource any of the company’s core functions other than those that have been specifically permitted by the Authority. Every outsourcing contract shall contain explicit safeguards regarding confidentiality of data and all outputs from the data, continuing ownership of the data with the insurer and orderly handing over of the data and all related software programs on termination of the outsourcing arrangement.

10.2 The management of the insurance company shall monitor and review the performance of agencies to whom operations have been outsourced at least annually and report findings to the Board.

10.3 The Authority reserves the right to access the operations of the outsourced entity to the extent these are relevant to the insurance company and for the protection of policyholder.

11. Interaction with the Regulator

11.1 Effective corporate governance practices in the office of the insurance company will enable IRDAI to have greater confidence in the work and judgment of its board, Key Management Persons and control functions.

11.2 In assessing the governance practices in place, the IRDAI would:
• Seek confirmation that the insurance company has adopted and effectively implemented sound corporate governance policies and practices;
• Assess the fitness and propriety of board members;
• Monitor the performance of boards;
• Assess the quality of insurance company’s internal reporting, risk management, audit and control functions;
• Evaluate the effects of the insurance company’s group structure on the governance strategies;
• Assess the adequacy of governance processes in the area of crisis management and business continuity.

11.3 The IRDAI would bring to the attention of the Board and senior management, concerns which have been detected by it through supervisory activities.

11.4 Reporting to IRDAI

11.4.1 Insurers should examine to what extent they are currently complying with these guidelines and initiate immediate action to achieve compliance (where not already in compliance) within a period of three months from the date of notification of these guidelines. It is expected that all the arrangements should be in place to ensure full compliance with the guidelines from the financial year 2016-2017. Where such compliance is not possible for any specific reason, the insurance companies should write to the IRDAI for further guidance.

11.4.2 Each insurer should designate Company Secretary as the Compliance officer whose duty will be to monitor continuing compliance with these guidelines.

11.4.3 Annual Report of insurers shall have a separate certification from the Compliance Officer in the format attached herewith as Annexure 8.

11.4.4 All insurers are required to file a report on status of compliance with the Corporate Governance guidelines on an annual basis. This report shall be filed within 3 months from the end of the financial year, i.e., before 30 June. The report shall be filed as per the format in the Annexure 9.

12. Whistle Blower Policy

12.1 Insurers are well advised to put in place a “whistle blower” policy, where-by mechanisms exist for employees to raise concerns internally about possible irregularities, governance weaknesses, financial reporting issues or other such matters. These could include employee reporting in confidence directly to the Chairman of the Board or of a Committee of the Board or to the Statutory Auditor.

The Policy illustratively covers the following aspects:

• Awareness of the employees that such channels are available, how to use them and how their report will be handled.
• Handling of the reports received confidentially, for independent assessment, investigation and where necessary for taking appropriate follow-up actions.
• A robust anti-retaliation policy to protect employees who make reports in good faith.
• Briefing of the board of directors.

12.2 The appointed actuary and the statutory/internal auditors have the duty to ‘whistle blow’, i.e., to report in a timely manner to the IRDAI if they are aware that the insurance company has failed to take appropriate steps to rectify a matter which has a material adverse effect on its financial condition. This would enable the IRDAI to take prompt action before policyholders’ interests are undermined.
13. Evaluation of Board of Directors including Independent Directors

As required under Schedule IV of the Companies Act, 2013, the independent directors shall meet at least once in a year to evaluate the performance of other than independent Directors. Similarly, there shall be an evaluation of the Independent Directors by the other members of the Board of Directors as required in the Schedule.

STEWARDSHIP CODE FOR INSURERS IN INDIA

Insurance companies are significant institutional investors in listed companies and the investments are held by them as custodians of policyholders. Therefore, it is felt that insurance companies should play an active role in the general meetings of investee companies and engage with the managements at a greater level to improve their governance. This will result in informed decisions by the parties and ultimately improve the return on investments of insurers.

Therefore, the IRDAI has decided to implement a code for stewardship for the insurers. The code is in the form of a set of principles, which the insurers would need to adopt. The principles are being uniformly adopted for institutional investors, like Mutual Funds, Pension Funds, Foreign Portfolio Investors (FPIs), Alternative Investment Funds (AIFs), etc. The code broadly requires the insurers to have a policy as regards their conduct at general meetings of the investee companies and the disclosures relating thereto. It is applicable from FY 2017-18.

All insurers need to draw up a policy based on the principles spelt out in the stewardship code within 6 months from the date of issue of these guidelines and the Board of Directors should approve the same. The policy should be disclosed on the website within 30 days of approval by the Board by all insurers, alongside the public disclosures. Any change/ modification to the policy on stewardship should be specifically disclosed at the time of updating the policy document on the website.

All insurers should file a status report to the Authority on an exception basis (comply or explain), as per the format placed at Annexure A on an annual basis indicating the reasons/ justification for the deviation or non-compliance with the principles indicated in these guidelines.

Annexure A

Format for annual reporting of compliance status of stewardship code to the Authority

Name of Insurer: ____________________
Period of Report (FY): ____________________
Status of Compliance with Stewardship Principles

<table>
<thead>
<tr>
<th>Sr No.</th>
<th>Particulars of Principles of Stewardship Code</th>
<th>Status (Deviation, Partly complied, Not complied)</th>
<th>Reason/ Justification for deviation or non-compliance</th>
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Compliance Officer
(Name and Signature)
The principles and the guidance for their implementation are given below:

**Stewardship Principles**

**Principle 1**

Insurers should formulate a policy on the discharge of their stewardship responsibilities and publicly disclose it.

**Guidance**

Stewardship activities include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration.

The policy should clearly define the stewardship responsibilities as identified by the insurer and how it intends to fulfill the same to enhance the wealth of its clients. The policy should disclose how the insurer applies stewardship with the aim of enhancing and protecting the value for the ultimate beneficiary or client.

In case some of the activities are outsourced to some external service providers, the policy should provide the responsibilities to be delegated to such service providers and the mechanisms to ensure that the overall stewardship responsibilities are carried out seamlessly.

**Principle 2**

Insurers should have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities and publicly disclose it.

**Guidance**

Insurers should put in place, maintain and publicly disclose a policy for identifying and managing conflicts of interest with the aim of taking all reasonable steps to put the interests of their client or beneficiary first. The policy should identify scenarios of likely conflict of interest as envisaged by the Board and should also address how matters are handled when the interests of clients or beneficiaries diverge from each other.

**Principle 3**

Insurers should monitor their investee companies.

**Guidance**

Insurers should have mechanisms for regular monitoring of their investee companies in respect of their performance, leadership effectiveness, succession planning, corporate governance, reporting and other parameters they consider important.

Insurers may or may not wish to have more participation through nominations on the Board for active involvement with the investee companies. An insurer who may be willing to have nominations on the Board of an investee company should indicate in its stewardship statement the willingness to do so, and the mechanism by which this could be done.

**Principle 4**

Insurers should have a clear policy on intervention in their investee companies.

**Guidance**

Insurers should set out the circumstances in which they will actively intervene and regularly assess the
outcomes of doing so. Intervention should be considered regardless of whether an active or passive investment policy is followed. In addition, a low volume of investment is not, in itself, a reason for not intervening. Instances when insurers may want to intervene include, but are not limited to, when they have concerns about the company’s strategy, performance, governance, remuneration or approach to risks, including those that may arise from social and environmental matters.

The meetings should be held in a confidential manner with the view to resolve the issue constructively. If dissatisfied with the response of the investee company, the insurer may decide to escalate the matter, in accordance with the pre-defined policy.

**Principle 5**

Insurers should have a clear policy for collaboration with other institutional investors, where required, to preserve the interests of the policyholders (ultimate investors), which should be disclosed.

**Guidance**

For issues that require larger engagement with the investee company, insurers may choose to act collectively with other institutional investors in order to safeguard the interests of their investors. For such situations, the insurers should have a policy to guide their actions and extent of engagement.

**Principle 6**

Insurers should have a clear policy on voting and disclosure of voting activity.

**Guidance**

Insurers should not just blindly support the board of the investee company but, instead, take their own voting decisions to promote the overall growth of the investee companies and, in turn, enhance the value of their investors.

The voting policy should be publicly disclosed. The voting decisions taken in respect of all the investee companies should also be disclosed publicly along with the rationale for such decision in Annexure B.

Insurers should disclose the use made, if any, of proxy voting or other voting advisory services. They should describe the scope of such services, identify the providers and disclose the extent to which they follow, rely upon or use recommendations made by such services.

Insurers should disclose their approach to stock lending and recalling lent stock.

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<th>Management Proposals</th>
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**Annexure B**

The format for disclosure of voting by insurance companies in general meetings of listed companies:
Principle 7

Insurers should report periodically on their stewardship activities.

Guidance

In addition to the regular fulfilment of their stewardship activities, institutional investors should also provide a periodic report to their ultimate beneficiaries (policyholders) of how they have discharged their responsibilities, in a format which is easy to understand.

However, it may be clarified that compliance with the aforesaid principles does not constitute an invitation to manage the affairs of a company or preclude a decision to sell a holding when this is considered in the best interest of clients or beneficiaries.

Disclosure and Reporting:

It is clarified that compliance with the aforesaid principles does not constitute an invitation to manage the affairs of a company or preclude a decision to sell a holding when this is considered in the best interest of clients or beneficiaries. The Board shall ensure that there is effective oversight on the insurer’s stewardship activities and a Committee of the Board entrusted with the compliance with corporate governance code shall exercise the same.

All insurers shall furnish a report on an annual basis to the IRDAI, on the status of compliance with the Stewardship Code. The status report, approved by the Board shall be endorsed by the Compliance Officer and should be submitted on or before 30th June every year. The reporting should be done under the principle of “comply or explain”, the reasons for deviation or non-compliance with the Stewardship Principles should be provided in the report.

CORPORATE GOVERNANCE IN PUBLIC SECTOR ENTERPRISES

Department of Public Enterprises (DPE) is the nodal department for issuing the corporate governance guidelines for the Public Sector Enterprises for both at center and state level. Since Government is the major shareholder in Public Sector Undertakings (PSUs)/Central Public Sector Enterprises (CPSEs), it is responsible to set the high standard of governance to be followed by these public sector enterprises. As the government’s disinvestment strategy gathers momentum, there is a genuine need to improve the levels of transparency, and accountability within PSUs.

To bring in more transparency and accountability in the functioning of CPSEs, the Government in June, 2007 introduced, for an experimental period of one year, the Guidelines on Corporate Governance for CPSEs. These Guidelines were of voluntary nature. Since the issue of these guidelines, the CPSEs have had the opportunity to implement them for the whole of the financial year 2008-09. These Guidelines have been modified and improved upon based on the experience gained during the experimental period of one year.
The Government have felt the need for continuing the adoption of good Corporate Governance Guidelines by CPSEs for ensuring higher level of transparency and decided to make these Guidelines mandatory and applicable to all CPSEs. Accordingly, revised Guidelines on Corporate Governance for Central Public Sector Enterprises was issued by DPE in 2010.

Apart from these instructions of DPE, the CPSEs are governed by the Companies Act, 2013 and regulations of various authorities like Comptroller and Auditor General of India (C&AG), Central Vigilance Commission (CVC), Administrative Ministries, other nodal Ministries, etc. In case of Listed CPSEs the Listing Agreement would also be applicable in addition to other applicable laws and DPE Guidelines. For the purpose of DPE Guidelines on Corporate Governance, CPSEs have been categorised into two groups, namely, (i) those listed on the Stock Exchanges; (ii) those not listed on the Stock Exchanges.

**CPSEs listed on Stock Exchanges:** In so far as listed CPSEs are concerned, they have to follow the SEBI Guidelines on Corporate Governance. In addition, they shall follow those provisions in these Guidelines which do not exist in the SEBI Guidelines and also do not contradict any of the provisions of the SEBI Guidelines.

**Unlisted CPSEs:** Each CPSE should strive to institutionalize good Corporate Governance practices broadly in conformity with the SEBI Guidelines. The listing of the non-listed CPSEs on the stock exchanges may also be considered within a reasonable time frame to be set by the Administrative Ministry concerned in consultation with the CPSEs concerned. The non-listed CPSEs shall follow the Guidelines on Corporate Governance on a mandatory basis.

DPE guidelines on Corporate Governance provide following governance parameters

- Board of Directors
- Audit Committee
- Remuneration Committee
- Subsidiary Companies
- Disclosures
- Report, Compliance and Schedule of Implementation

While listed PSUs are required to comply with the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, it is also mandatory for all Central Public Sector Enterprises (CPSEs) to comply with the corporate governance norms rolled out by the Department of Public Enterprises.

**Salient features of Guidelines on Corporate Governance for Central Public Sector Enterprises 2010:**

**(a) Board of Directors:**

*Composition of Board of Directors:* The Board of Directors of the company shall have an optimum combination of Functional, Nominee and Independent Directors. The number of Functional Directors (including CMD/MD) should not exceed 50% of the actual strength of the Board. The number of Nominee Directors appointed by Government/other CPSEs shall be restricted to a maximum of two. In case of a CPSE listed on the Stock Exchanges and whose Board of Directors is headed by an Executive Chairman, the number of Independent Directors shall be at least 50% of Board Members; and in case of all other CPSEs (i.e. listed on Stock Exchange but without an Executive Chairman, or not listed CPSEs), at least one-third of the Board Members should be Independent Directors.

*Part-time Directors’ compensation and disclosures:* All fees/compensation, if any, paid to part-time
Directors, including Independent Directors, shall be fixed by the Board of Directors subject to the provisions in the DPE guidelines and the Companies Act, 2013.

**Number of Board meetings:** The Board shall meet at least once in every three months and at least four such meetings shall be held every year. Further, the time gap between any two meetings should not be more than three months. A Director shall not be a member in more than 10 committees or act as Chairman of more than five committees across all companies in which he is a Director. Furthermore it should be a mandatory annual requirement for every Director to inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.

**Compliance of Laws to be reviewed:** The Board shall periodically review compliance reports of all laws applicable to the company, prepared by the company as well as steps taken by the company to rectify instances of non-compliances.

**Code of Conduct:** The Board shall lay down a code of conduct for all Board members and senior management of the company. The code of conduct shall be circulated and also posted on the website of the company. All Board members and senior management personnel shall affirm compliance with the code on an annual basis. The Annual Report of the company shall contain a declaration to this effect signed by its Chief Executive. Guidelines and policies evolved by the Central Government with respect to the structure, composition, selection, appointment and service conditions of Boards of Directors and senior management personnel shall be strictly followed. There shall be no extravagance in expenditure on the part of Board members and senior management personnel. CPSEs executives shall be accountable for their performance in conformity with established norms of conduct. Any external/internal changes made from time to time, due to addition of or amendment to laws/regulatory rules, applicable to CPSEs, need to be dealt with carefully by the respective Boards/senior management personnel.

**Functional Role Clarity between Board of Directors and Management:** A clear definition of the roles and the division of responsibilities between the Board and the Management is necessary to enable the Board to effectively perform its role. The Board should have a formal statement of Board Charter which clearly defines the roles and responsibilities of the Board and individual Directors. The Board of each CPSE may be encouraged to articulate its Corporate Governance objectives and approach (within the broad parameters of these guidelines and the general perception of business risk) to satisfy the expectations of its majority shareholders and other stakeholders.

**Risk Management:** Enterprise risk management helps management in achieving CPSE's performance and profitability targets. It helps to ensure effective reporting and compliance with laws and regulations, and helps avoid damage to the entity’s reputation and associated consequences. Considering the significance of risk management in the scheme of corporate management strategies, its oversight should be one of the main responsibilities of the Board/Management. The Board should ensure the integration and alignment of the risk management system with the corporate and operational objectives and also that risk management is undertaken as a part of normal business practice and not as a separate task at set times.

**Training of Directors:** The company concerned shall undertake training programme for its new Board members (Functional, Government, Nominee and Independent) in the business model of the company including risk profile of the business of company, responsibility of respective Directors and the manner in which such responsibilities are to be discharged. They shall also be imparted training on Corporate Governance, model code of business ethics and conduct applicable for the respective Directors.
(b) Audit Committee

**Qualified and Independent Audit Committee:** A qualified and independent Audit Committee shall be set up, giving the terms of reference. The Audit Committee shall have minimum three Directors as members. Two-thirds of the members of audit committee shall be Independent Directors. The Chairman of the Audit Committee shall be an Independent Director. All members of Audit Committee shall have knowledge of financial matters of Company, and at least one member shall have good knowledge of accounting and related financial management expertise. The Chairman of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries; provided that in case the Chairman is unable to attend due to unavoidable reasons, he may nominate any member of the Audit Committee.

The Audit Committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the Committee. The Audit Committee may also meet without the presence of any executives of the company. The Finance Director, Head of Internal Audit and a representative of the Statutory Auditor may be specifically invited to be present as invitees for the meetings of the Audit Committee as may be decided by the Chairman of the Audit Committee. The Company Secretary shall act as the Secretary to the Audit Committee.

**Role of Audit Committee:** The role of the Audit Committee shall include the following:

- Oversight of the company’s financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
- Recommending to the Board the fixation of audit fees.
- Approval of payment to statutory auditors for any other services rendered by the statutory auditors.
- Reviewing, with the management, the annual financial statements before submission to the Board for approval, with particular reference to: (a) Matters required to be included in the Directors’ Responsibility Statement to be included in the Board’s report (b) Changes, if any, in accounting policies and practices and reasons for the same; (c) Major accounting entries involving estimates based on the exercise of judgment by management; (d) Significant adjustments made in the financial statements arising out of audit findings; (e) Compliance with legal requirements relating to financial statements; (f) Disclosure of any related party transactions; and (g) Qualifications in the draft audit report.
- Reviewing, with the management, the quarterly financial statements before submission to the Board for approval.
- Reviewing, with the management, performance of internal auditors and adequacy of the internal control systems.
- Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure, coverage and frequency of internal audit.
- Discussion with internal auditors and/or auditors any significant findings and follow up there on.
- Reviewing the findings of any internal investigations by the internal auditors/auditors/agencies into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the Board.
- Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.
- To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.
• To review the functioning of the Whistle Blower Mechanism.
• To review the follow up action on the audit observations of the C&AG audit.
• To review the follow up action taken on the recommendations of Committee on Public Undertakings (COPU) of the Parliament.
• Provide an open avenue of communication between the independent auditor, internal auditor and the Board of Directors
• Review all related party transactions in the company. For this purpose, the Audit Committee may designate a member who shall be responsible for reviewing related party transactions.
• Review with the independent auditor the co-ordination of audit efforts to assure completeness of coverage, reduction of redundant efforts, and the effective use of all audit resources.
• Consider and review the following with the independent auditor and the management: (i) The adequacy of internal controls including computerized information (ii) system controls and security, and -Related findings and recommendations of the independent auditor and internal auditor, together with the management responses.
• Consider and review the following with the management, internal auditor and the independent auditor: (i) Significant findings during the year, including the status of previous audit recommendations (ii) - Any difficulties encountered during audit work including any restrictions on the scope of activities or access to required information.

**Powers of Audit Committee:** Commensurate with its role, the Audit Committee should be invested by the Board of Directors with sufficient powers, which should include the following:

• To investigate any activity within its terms of reference.
• To seek information on and from any employee.
• To obtain outside legal or other professional advice, subject to the approval of the Board of Directors.
• To secure attendance of outsiders with relevant expertise, if it considers necessary.
• To protect whistle blowers.

**Meeting of Audit Committee:** The Audit Committee should meet at least four times in a year and not more than four months shall elapse between two meetings. The quorum shall be either two members or one third of the members of the Audit Committee whichever is greater, but a minimum of two independent members must be present.

**Review of information by Audit Committee:** The Audit Committee shall review the following information:

• Management discussion and analysis of financial condition and results of operations;
• Statement of related party transactions submitted by management;
• Management letters/letters of internal control weaknesses issued by the statutory auditors;
• Internal audit reports relating to internal control weaknesses;
• The appointment and removal of the Chief Internal Auditor shall be placed before the Audit Committee; and Certification/declaration of financial statements by the Chief Executive/Chief Finance Officer.
(c) **Remuneration Committee:** Each CPSE shall constitute a Remuneration Committee comprising of at least three Directors, all of whom should be part-time Directors (i.e. Nominee Directors or Independent Directors). The Committee should be headed by an Independent Director. CPSE will not be eligible for Performance Related Pay unless the Independent Directors are on its Board. Remuneration Committee will decide the annual bonus/variable pay pool and policy for its distribution across the executives and non unionized supervisors, within the prescribed limits.

(d) **Subsidiary Companies:** At least one Independent Director on the Board of Directors of the holding company shall be a Director on the Board of Directors of its subsidiary company. The Audit Committee of the holding company shall also review the financial statements of its subsidiary company. The minutes of the Board meetings of the subsidiary company shall be placed at the Board meeting of the holding company. The management should periodically bring to the attention of the Board of Directors of the holding company, a statement of all significant transactions and arrangements entered into by its subsidiary company.

**Explanation:** For the purpose of these guidelines, only those subsidiaries whose turnover or net worth is not less than 20% of the turnover or net worth respectively of the Holding company in the immediate preceding accounting year may be treated as subsidiary companies.

(e) **Disclosure:**

**Transactions:** A statement in summary form of transactions with related parties in the normal and ordinary course of business shall be placed periodically before the Audit Committee. Details of material individual transactions with related parties, which are not in the normal and ordinary course of business, shall be placed before the Audit Committee. Details of material individual transactions with related parties or others, which are not on an arm’s length basis should be placed before the Audit Committee, together with Management’s justification for the same.

**Accounting Standards:** Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management's explanation in the Corporate Governance Report as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction.

**Board Disclosures – Risk management:**

- The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework. Procedure will be laid down for internal risk management also.

- The Board should implement policies and procedures which should include: (a) staff responsibilities in relation to fraud prevention and identification (b) responsibility of fraud investigation once a fraud has been identified (c) process of reporting on fraud related matters to management (d) reporting and recording processes to be followed to record allegations of fraud (e) requirements of training to be conducted on fraud prevention and identification.

**Remuneration of Directors:**

- All pecuniary relationship or transactions of the part-time Directors vis-à-vis the company shall be disclosed in the Annual Report.

- Further the following disclosures on the remuneration of Directors shall be made in the section on the Corporate Governance of the Annual Report: (a) All elements of remuneration package of all the
directors i.e. salary, benefits, bonuses, stock options, pension, etc. (b) Details of fixed component and performance linked incentives, along with the performance criteria (c) Service contracts, notice period, severance fees. (d) Stock option details, if any – and whether issued at a discount as well as the period over which accrued and over which exercisable.

Management: As part of the Directors Report or as an addition thereto, a Management Discussion and Analysis Report should form part of the Annual Report. This Management Discussion and Analysis should include discussion on the following matters within the limits set by the company’s competitive position: (a) Industry structure and developments, (b) Strength and weakness (c) Opportunities and Threats (d) Segment-wise or product-wise performance (e) Outlook (f) Risks and concerns (g) Internal control systems and their adequacy (h) Discussion on financial performance with respect to operational performance (i) Material developments in Human Resources, Industrial Relations front, including number of people employed. (j) Environmental Protection and Conservation, Technological conservation, Renewable energy developments, Foreign Exchange conservation (k) Corporate social responsibility.

Senior management shall make disclosures to the board relating to all material financial and commercial transactions, where they have personal interest that may have a potential conflict with the interest of the company (e.g. dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives, etc.)

Explanation: For this purpose, the term “senior management” shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the Functional Directors, including all functional heads.

Report on Corporate Governance: There shall be a separate section on Corporate Governance in each Annual Report of company, with details of compliance on Corporate Governance.

Compliance: The company shall obtain a certificate from either the auditors or practicing Company Secretary regarding compliance of conditions of Corporate Governance as stipulated in these Guidelines and Annexes. The aforesaid certificate with the Directors” Report, which is sent annually to all the shareholders of the company, should also be included in the Annual Report. Chairman’s speech in Annual General Meeting (AGM) should also carry a section on compliance with Corporate Governance guidelines/norms and should form part of the Annual Reports of the concerned CPSE. The grading of CPSEs may be done by DPE on the basis of the compliance with Corporate Governance guidelines/norms.

Schedule of implementation: These Guidelines on Corporate Governance are now mandatory. The CPSEs shall submit quarterly progress reports, within 15 days from the close of each quarter, in the prescribed format to respective Administrative Ministries/ Departments. The Administrative Ministries will consolidate the information obtained from the CPSEs and furnish a comprehensive report to the DPE by 31st May of every financial year on the status of compliance of Corporate Governance Guidelines during the previous financial year by the CPSEs under their jurisdiction. DPE will, from time to time, make suitable modifications to these Guidelines in order to bring them in line with prevailing laws, regulations, acts, etc., DPE may also issue clarifications to the concerned Administrative Ministries/CPSEs on issues relating to the implementation of these Guidelines.

GUIDELINES ON CORPORATE SOCIAL RESPONSIBILITY AND SUSTAINABILITY FOR CENTRAL PUBLIC SECTOR ENTERPRISES (WITH EFFECT FROM 1ST APRIL, 2013)

Prior to the notification of CSR Rules under the Companies Act 2013, DPE Guidelines on CSR and Sustainability issued in December 2012, were applicable to all CPSEs w.e.f. 01.04.2013.
After the enactment of the Companies Act 2013, all CPSEs shall have to comply with the provisions of the Act and the CSR Rules. Any amendment notified by the Ministry of Corporate Affairs in the CSR Rules, or in Schedule VII of the Act will also be binding on the CPSEs. Along with these, Guidelines on Corporate Social Responsibility and Sustainability for Central Public Sector Enterprises, 2014 have been notified by DPE shall be applicable to all CPSEs.

In earlier DPE guidelines, CSR and sustainable development were treated as complementary and, therefore, dealt with together. CSR was seen as an important constituent of the overarching framework of sustainability. The present guidelines of DPE are also intended to reinforce the complementarity of CSR and sustainability and to advise the CPSEs not to overlook the larger objective of sustainable development in the conduct of business and in pursuit of CSR agenda.

The Revised Guidelines applicable to all CPSEs are generally in the nature of guiding principles. The guidelines contain certain additional requirements as mentioned below:

1. It is mandatory for all profit making CPSEs to undertake CSR activities as per the provisions of the Act and the CSR Rules. Even the CPSEs which are not covered under the eligibility criteria based on threshold limits of net-worth, turnover, or net profit as specified by Section 135 (1) of the Act, but which made profit in the preceding year, would also be required to take up CSR activities as specified in the Act and the CSR Rules, and such CPSEs would be expected to spend at least 2% of the profit made in the preceding year on CSR activities.

2. All CPSEs must adopt a CSR and Sustainability Policy specific to their company with the approval of the Board of Directors. The philosophy and spirit of CSR and Sustainability must be firmly ingrained in the policy and it must be consistent with the CSR provisions of the Act, Schedule VII of the Act, CSR Rules, the Guidelines, and the policy directions issued by the Government from time to time. The CSR and Sustainability policy of a CPSE should serve as the referral document for planning its CSR activities in accordance with Schedule VII of the Act and give a road map for formulation of actionable plans.

3. If the CPSEs feel the necessity of taking up new CSR activities / projects during the course of a year, which are in addition to the CSR activities already incorporated in the CSR policy of the company, the Board’s approval of such additional CSR activities would be treated as amendment to the policy.

4. It would be mandatory for all CPSEs which meet the criteria as laid down in Section 135(1) of the Act, to spend at least 2% of the average net profits of the three immediately preceding financial years in pursuance of their CSR activities as stipulated in the Act and the CSR Rules. This stipulated percentage of average net profits is to be spent every year in a manner specified in the Act and CSR Rules. In case a company fails to spend such amount, it shall have to specify the reasons for not spending it. However, in case of CPSEs mere reporting and explaining the reasons for not spending this amount in a particular year would not suffice and the unspent CSR amount in a particular year would not lapse. It would instead be carried forward to the next year for utilisation for the purpose for which it was allocated.

5. While selecting CSR activities / projects from the activities listed in Schedule VII of the Act, CPSEs should give priority to the issues which are of foremost concern in the national development agenda, like safe drinking water for all, provision of toilets especially for girls, health and sanitation, education, etc. The main focus of CSR and Sustainability policy of CPSEs should be on sustainable development and inclusive growth, and to address the basic needs of the deprived, 5 under
privileged, neglected and weaker sections of the society which comprise of SC, ST, OBCs, minorities, BPL families, old and aged, women / girl child, physically challenged, etc.

6. For CPSEs to fully exploit their core competence and mobilize their resource capabilities in the implementation of CSR activities / projects, they are advised to align their CSR and Sustainability policy with their business policies and strategies to the extent possible, and select such CSR activities / projects which can be better monitored through in-house expertise.

7. All CPSEs are expected to act in a socially, economically and environmentally sustainable manner at all times. Even in their normal business activities, public sector companies should try to promote sustainable development through sustainability initiatives by conducting business in a manner that is beneficial to both, business and society. They are advised not to lose sight of their social and environmental responsibility and commitment to sustainable development even in activities undertaken in pursuance of their normal course of business. National and global sustainability standards which promote ethical practices, transparency and accountability in business may be referred to as guiding frameworks to plan, implement, monitor and report sustainability initiatives. But the amount spent on sustainability initiatives in the pursuit of sustainable development while conducting normal business activities would not constitute a part of the CSR spend from 2% of profits as stipulated in the Act and the CSR Rules.

8. As a part of their sustainability initiatives CPSEs are expected to give importance to environmental sustainability even in their normal mainstream activities by ensuring that their internal operations and processes promote renewable sources of energy, reduce / re-use / recycle waste material, replenish ground water supply, protect / conserve / restore the ecosystem, reduce carbon emissions and help in greening the supply chain. CPSEs are expected to behave in a responsible manner by producing goods and services which are safe and healthy for the consumers and the environment, resource efficient, consumer friendly, and environmentally sustainable throughout their life cycles i.e. from the stage of raw material extraction to production, use / consumption, and final disposal. However, such sustainability initiatives will not be considered as CSR activities as specified in the CSR Rules, and the expenditure incurred thereon would also not constitute a part of the CSR spend. Nevertheless, CPSEs are encouraged to take up such sustainability initiatives from their normal budgetary expenditure as it would demonstrate their commitment to sustainable development.

9. Sustainability initiatives would also include steps taken by CPSEs to promote welfare of employees, especially women, physically challenged, SC / ST / OBC categories, by addressing their concerns of safety, security, professional enrichment and healthy working conditions beyond what is mandated by law. However, expenditure on such sustainability initiatives would not qualify as CSR spend.

10. The philosophy and spirit of CSR and Sustainability should be understood and imbibed by the employees at all levels and get embedded in the core values of the company.

11. CPSEs should extend their reach and oversight to the entire supply chain network to ensure that as far as possible suppliers, vendors, service providers, clients, and partners are also committed to the same principles and standards of corporate social responsibility and sustainability as the company itself. CPSEs are encouraged to initiate and implement measures aimed at `greening' the supply chain.

12. As mentioned in the Act, CPSEs should give preference to the ‘local area’ in selecting the location of their CSR activities. It is desirable that the Board of Directors of CPSEs define the scope of the
‘local area’ of their commercial units / plants / projects, keeping in view the nature of their commercial operations, the extent of the impact of their operations on society and environment, and the suggestions / demands of the key stakeholders, especially those who are directly impacted by the company’s commercial operations / activities. The definition of ‘local area’ may form part of the CSR policy of the CPSE.

13. After giving due preference to the local area, CPSEs may also undertake CSR activities anywhere in the country. The Board of Directors of each CPSE may also decide on an indicative ratio of CSR spend between the local area and outside it, and this may be mentioned in the CSR policy of the CPSE. CPSEs, which by the very nature of their business have no specific geographical area of commercial operations, may take up CSR activities / projects at any location of their choice within the country.

14. As far as possible, CPSEs should take up the CSR activities in project, which entails planning the stages of execution in advance by fixing targets at different milestones, with pre-estimation of quantum of resources required within the allocated budget, and having a definite time span for achieving desired outcomes.

15. CPSEs should devise a communication strategy for regular dialogue and consultation with key stakeholders to ascertain their views and suggestions regarding the CSR activities and sustainability initiatives undertaken by the company. However, the ultimate decision in the selection and implementation of CSR activities would be that of the Board of the CPSE.

16. As per the CSR Rules, all companies are required to include an annual report on CSR in their Board’s Report. The template / format for reporting CSR activities as provided by CSR Rules should be strictly adhered to. However, CPSEs shall also have to include in the Board’s Report a brief narrative on the action taken for the implementation of the Guidelines so that the stakeholders are informed of not only the CSR activities but also of the sustainability initiatives taken by the CPSEs. CPSEs are further advised to prepare an Annual Sustainability Report, which would go a long way in imparting greater transparency and accountability to the company’s operations, apart from improving the brand image.

17. It is desirable that CPSEs get a baseline/ need assessment survey done prior to the selection of any CSR activity. It is also desirable that CPSEs should get an impact assessment study done by external agencies of the CSR activities / projects undertaken by them. Impact assessment is mandatory for mega projects, the threshold value of which can be determined by the Board of a CPSE and specified in its CSR and Sustainability policy. However, the expenditure incurred on baseline survey and impact assessment study should be within the overall limit of 5% of administrative overheads of CSR spend as provided for under the CSR Rules.

18. Within the provisions of the Act, Schedule VII of the Act, and the CSR Rules, CPSEs are encouraged to take up CSR activities / projects in collaboration with other CPSEs for greater social, economic and environmental impact of their CSR activities/projects.

GLOSSARY OF TECHNICAL WORDS

- **Insurance Company**: A company that calculates the risk of occurrence then determines the cost to replace (pay for) the loss to determine the premium amount. A business that provides coverage, in the form of compensation resulting from loss, damages, injury, treatment or hardship in exchange for premium payments.

- **Banking Company**: "banking company" means a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949
• **NBFC’s:** A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property. A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in instalments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

• **Whistle Blower Policy:** A whistleblower as defined by this policy is an employee of (Name of Company/Organization) who reports an activity that he/she considers to be illegal or dishonest to one or more of the parties specified in this Policy.

• **CPSEs:** Central Public Sector Enterprises (CPSEs) are those companies in which the direct holding of the Central Government or other CPSEs is 51% or more.

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**LESSON ROUND UP**

- Corporate Governance as the application of best management practices compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders.

- The companies listed with Stock Exchanges have to adhere to the SEBI (LODR) Regulations, 2015 in addition to the provisions of the Companies Act or the Act under which they been formed. The banks under governed by the different statutes hence the respective Acts under which they have been incorporated have to comply with that requirement along with the directives of the Regulatory Authorities (like RBI for Banks and IRDA for Insurance).

- The inception of the Corporate Governance norms may for banks may firstly be treated when the RBI accepted and published the Ganguly Committee Recommendations. Since India is also following the best practices as enunciated by the Basel Committee and adopted by the banks in India as per the directions of the RBI, the Corporate Governance Norms as suggested in Basel I, II and III has also been elaborated in the chapter.

- The Corporate Governance norms for insurance companies are governed by the IRDA guidelines.

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**REFERENCE FOR FURTHER READING**

Circulars DNBS(PD) CC. No.61/02.82/2005-06 dated December 12, 2005, DNBS(PD) CC. No.94/03.10.042/2006-07 dated May 8, 2007 and DNBS(PD) CC. No.104/03.10.042/2007-08 dated July 11, 2007 on Corporate Governance


https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf

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**SELF TEST QUESTIONS**

*(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)*

1. What do you mean by the Corporate Governance? How the governance norms are applicable in the banks.

2. Discuss the salient features of the Ganguly Committee Report applicable to Private Sector Banks.

3. IRDA has issued the guidelines on Corporate Governance Norms for the Insurance Companies.
Please mention the salient features of it.

4. Public Sector Undertakings have also to adhere the norms of the Corporate Governance. What guidelines have been issued by the Ministry in this regard?

5. Comments on the Corporate Social Responsibility.

6. DPE has issued the guidelines on Corporate Governance for the CPSEs. Discuss in brief.
Lesson 4
Board Effectiveness-Issues and Challenges

LESSON OUTLINE

- Introduction
- Role of Directors
- Types of Board
- Governance Functionaries
- Board Charter
- Board Processes through Secretarial Standards
- Responsibilities of Board
- Responsibility for Leadership
- Difference between directors and executives
- Training of Directors
- Performance Evaluation of Board
- Conclusion
- Glossary
- Lesson Round-Up
- Self Test Questions

LEARNING OBJECTIVES

The objective of this study lesson is to enable the students to understand the Board Composition and its effectiveness and various issues and challenges to board effectiveness through four well divided segments.

The first segment of the study enables the students to understand the role of directors, types of boards, diversity in Boardrooms, Governance Functionaries, Chairman & Chief Executive Officer, separation of Power and Lead Independent Director; The second segment of the study focuses on Board processes & Board Charter.

The third segment of the study enables the students to understand the concept of Board responsibility, Leadership Development, Relationship between Directors and Executives, The key difference between Directors and Managers, Barriers to Visionary Leadership and related matters.

The last segment of this study enables the students to understand the – importance of Director Induction and Development programmes, Performance Review of Board & Individual Directors, Major Factors for Evaluation, Parameters and Model questions for Evaluation purpose.

“\textit{A well balanced, inclusive approach, according to certain standard and ideals, is essential for the proper governance of any country}”

- Laisenia Qarase
INTRODUCTION

The contribution of directors on the Board of companies is critical for ensuring appropriate directions with regard to leadership, vision, strategy, policies, monitoring, supervision, accountability to shareholders and other stakeholders, and to achieving greater levels of performance on a sustained basis as well as adherence to the best practices of corporate governance.

Evolution of Jurisprudence

The institution of board of directors was based on the premise that a group of trustworthy and respectable people should look after the interests of the large number of shareholders who are not directly involved in the management of the company. The position of the board of directors is that of trust as the board is entrusted with the responsibility to act in the best interests of the company.

The board’s role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed.

The Board of Directors plays a pivotal role in ensuring good governance. The contribution of directors on the Board is critical to the way a corporate conducts itself. A board’s responsibilities derive from law, custom, tradition and prevailing practices.

The Board is vested with the responsibility of enhancing the economic efficiency and competitiveness of the company. The Board must therefore direct the business of the organization with fairness and due regard to stakeholders’ value and stake in the enterprise. It is incumbent upon the board to ensure that timely, accurate and complete reports on all relevant aspects of the organization are issued to the stakeholders and for the said purpose it should put in place proper reporting systems.

In the present times transparency, disclosure, accountability, issues of sustainability, corporate citizenship, globalization are some of the concerns that the Boards have to deal with. In addition, the Boards have to respond to the explosive demands of the marketplace. This two dimensional role of the Board of Directors is the cornerstone in evolving a sound, efficient, vibrant and dynamic corporate sector for attaining of high standards in integrity, transparency, conduct, accountability as well as social responsibility.

SEGMENT I

ROLE OF DIRECTORS

To establish the Vision & Mission Statement: Determination and approval of company’s philosophy, values, vision and mission statement is done by the board of directors. While doing so, it must be discerned that the company’s activities are consistent with its stated purpose. The Board ensures that the company effectively and efficiently works towards achieving its mission and is committed to continual quality improvement. Based
on the value of quality, openness, integrity, responsibility and accountability, board members and employees should set the pace of for its current operations and future developments and act in the best interest of achieving the company’s mission at all times.

Strategic Direction and advice: Board is to review and approve management’s strategy, plans and decisions, financial objectives and extra-ordinary business transactions. Boards are in an excellent position to determine the strategic options, select those to be pursued and decide the means to implement and support the same. By virtue of their position, they can also furnish input and advice to the CEO and the top management regarding the company’s strategic direction and ensure that the organizational structure and capability are appropriate for implementing those chosen strategies.

Overseeing Strategy Implementation and performance: Developing a valid strategy is only the first step in creating an effective organization. The board plays a crucial role in advising, evaluating and monitoring strategy implementation. Boards can best monitor strategy implementation by setting benchmarks to measure progress and by drawing on objective sources of information.

Appointing and evaluation of CEO and Senior management: It is the duty as well as the power of the Board to appoint the CEO, other officers to the senior management and specialist officers of the company. Boards need to be proactive in evaluating the performance of CEO and top management team. The Board has to be involved in planning the development of senior management. The board has responsibility for

- Hiring the senior managerial personnel;
- Giving direction to the senior managerial personnel, and;
- Evaluating the senior managerial personnel.

Ensuring Stakeholder Relations and ensuring accountability towards them: To serve as a communications link with members and other stakeholders of an organization - organization can accomplish this by informing people of upcoming events, promoting items of interest and providing newsworthy information. The Board should ensure that the communication from and to the shareholders and relevant stakeholders is effective.

To serve as a communication link with the general public- Promote the organization’s purpose, goals and objectives, programmes and activities before the public to foster awareness, accomplishments and opportunities for involvement.

Risk Mitigation: Directors are expected to identify and manage obstacles that may prevent the organization from reaching its goals. The entire board must be involved in risk management, particularly around financial matters and legal compliance. In managing risk, directors have a responsibility to owners to foresee what could affect the organization and to put in place plans that will minimise the impact of events or changes that will have a negative effect. Each company will have a different risk profile and appetite. Each board will identify the key risks affecting their own sector and then take steps to manage those risks.

Procuring resources: Financial resources, human resources, technological resources andbusiness relationship are the key resources that are essential to an organization’s success. Boards play an important role in helping the organization in procuring the resources.

Selection and Appointment of Directors

Board is critical to performance of the company and for this a robust selection and appointment process for directors is must. The company must ensure that the Board consists of members with the range of skills and
qualities to meet its primary responsibility for promoting the interest of the company in a way which ensures that the interests of shareholders and stakeholders are promoted and protected.

The Nomination and Remuneration Committee (NRC) should consider the selection and re-appointment of Directors and makes its recommendation to the Board. It should assess the current Board’s skills, experience and expertise to identify the skills that would best increase Board effectiveness. It must also assess the needs of the business currently and going forward. The Board should be structured in a way that it:-

- Has a proper understanding of, and competence to deal with, the current and emerging issues of the business
- Exercises independent judgement
- Encourages enhanced performance of the Company
- Can effectively review and challenge the performance of management.

The company should develop selection criteria for potential board candidate(s). Informal discussion may be carried by the NRC or the Board to generate a list of potential candidates who may fill the stated criteria. Where considered necessary, the company may use the services of an independent executive search firm to assess the appropriateness of potential candidates or to supplement a candidate list provided by directors. The NRC should measure -the final potential candidate(s) against the selection criteria and approach desired candidate(s) to obtain consent of intended director, and recommend to the Board.

The company should follow the legal process pertaining to appointment of directors to the Board. In addition, the company should prepare terms of reference and issue an appointment letter containing such terms to the appointed director.

**Who are Board of Directors?**

A board of directors is a body of elected or appointed members who jointly oversee the activities of a company. They are also referred as board of governors, board of managers, board of regents, board of trustees, or simply referred to as “the board”.

**TYPES OF BOARD**

**Unitary Board**

The unitary board, remains in full control of every aspect of the company’s activities. It initiates action and it is responsible for ensuring that the action which it has initiated is carried out. All the directors, whether executive or outside, share the same aims and responsibilities and are on the same platform.

**Two-tier Boards**

The alternative board model to unitary board is the two-tier board, which was developed in its present form in Germany. A two-tier board fulfils the same basic functions as a unitary board, but it does so through a clear separation between the tasks of monitoring and that of management. The supervisory board (Asfusichtsrat) oversees the direction of the business and the management board (Vorstand) is responsible for the running of the company. The supervisory board controls the management board through appointing its members and through its statutory right to have the final say in major decisions affecting the company. The structure
rigorously separates the control function from the management function and members of the one board cannot be members of the other. This separation is enshrined in law and the legal responsibilities of the two sets of board members are different. The supervisory board system was introduced to strengthen the control of shareholders, particularly the banks, over the companies in which they had invested. Shareholdings are more concentrated in Germany and most quoted companies have at least one major shareholder, often a family or another company. Banks play an important part in governance as investors, lenders and through the votes of individual shareholders for which they hold proxies. They are, therefore, well represented on supervisory boards.

Who are Directors?

Company being an artificial person it requires certain natural persons to represent the company at various fronts. The position of directors in their relationship to the company is not only as the agents, but also trustees of the company

GOVERNANCE FUNCTIONARIES

1. Executive Director

The term executive director is usually used to describe a person who is both a member of the board and who also has day-to-day responsibilities in respect of the affairs of the company. Executive directors perform operational and strategic business functions such as:

- managing people
- looking after assets
- hiring and firing
- entering into contracts

Executive directors are employed by the company and paid a salary, so are protected by employment law. Examples of executive directors are production director, finance director or managing director or whole time director.

Section 2(54) of the Companies Act, 2013 defines Managing Director as - "managing director" means a director who, by virtue of articles of a company or an agreement with the company or of a resolution passed by the company in general meeting or by its Board of directors,, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of a managing director, by whatever name called.

The explanation to section 2(54) excludes administrative acts of a routine nature when so authorised by the Board such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to draw and endorse any negotiable instrument or to sign any certificate of share or to direct registration of transfer of any share, from the substantial powers of management.

2. Non Executive Director

They are not in the employment of the company. They are the members of the Board, who normally do not take part in the day-to-day implementation of the company policy. They are generally appointed to provide
the company with the benefits of professional expertise and outside perspective to the board. They play an effective role in governance of listed companies, but they may or may not be independent directors.

3. Shadow Director

Shadow Director is a person who is not formally appointed as a director, but in accordance with whose directions or instructions the directors of a company are accustomed to act. This is a concept adopted from English law. However, a person is not a shadow director merely because the directors act on advice given by him in a professional capacity.

Holder of controlling or majority stock (share) of a private firm who is not (technically) a director and does not openly participate in the firm’s governance, but whose directions or instructions are routinely complied with by the employees or other directors. In the eyes of law, he or she is a de facto director and is held equally liable for the obligations of the firm with the other de facto and de jure directors.

Can a shadow director be counted for the Board Quorum?

4. Woman Director

Globally, the call for more gender diversity on corporate boards has been gaining momentum. The Companies Act, 2013 in India also recognizes the importance of gender diversity and provides for mandatory appointment of atleast one women director in the listed and other specified class of companies. It is increasingly being recognized that by bringing together men and women from diverse background and giving each person the opportunity to contribute their skills, experience and perspectives, the corporates are able to deliver the best solutions to challenges and sustainable value to their stakeholders. Organizations that aim to deliver the highest standards of leadership require a diversity of thought, skills, experience, working style and talent capability.

A progressive board is one that truly adopts diversity, has a broader perspective in an increasingly dynamic global market, possesses a wider set of innovative solutions and is better positioned to achieve outcomes and targets. In addition, a more diverse board is able to guide and advise its senior leadership in times of high volatility and risk which is a chief concern for all stakeholders and shareholders. The listed entities in India are required to devise a policy on diversity of board of directors (Regulation 19 of LODR). Second Proviso to section 149 provides that such class or classes of companies as may be prescribed in Companies (Appointment and Qualification of Directors) Rules, 2014, shall have at least one woman director.

Rule 3 of Companies (Appointment and Qualification of Directors) Rules, 2014, prescribes 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 one hundred crore rupees or more; or

(b) turnover of three hundred crore rupees or more .

A company, which has been incorporated under the Act and is covered under provisions of second proviso to sub-section (1) of section 149 shall comply with such provisions within a period of six months from the date
of its incorporation:

However any intermittent vacancy of a woman director shall be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy whichever is later.

Explanation.- For the purposes of this rule, it is hereby clarified that the paid up share capital or turnover, as the case may be, as on the last date of latest audited financial statements shall be taken into account.

Regulation 17(i) of the SEBI (LODR) Regulations also requires that at least one woman director shall be appointed on the board of all listed entities. SEBI (LODR) (Amendment) Regulations, 2018 provides that the top listed 500 companies shall have atleast one independent woman director by 1 April 2019 and for the top listed 1000 entities by 1 April 2020.

5. Resident Director

Section 149 (3) of the Act has provided for residence of a director in India as a compulsory i.e. every company shall have at least one director who has stayed in India for a total period of not less than 182 days in the previous calendar year. MCA has also issued clarification with regard to Resident Directors.

Clarification by MCA

1. Whether the provision regarding Resident Director is applicable in the current calendar/financial year.

The matter has been examined. It has been clarified that the, residency requirement would be reckoned from the date of commencement of section 14 of the Act i.e. 1st April, 2014, The first, previous calendar year, for compliance with these provisions would, therefore, be Calendar year 2014. The period to be taken into account for compliance with these provisions will be the remaining period of calendar year 2014 i.e. 1st April to 31st December. Therefore, on a proportionate basis the number of days for which the director(s) would need to be resident in India during Calendar year2014, shall exceed 136 days.

Regarding newly incorporated companies it is clarified that companies incorporated between 1.4.2014 to 30.9.2014 should have a resident director either at the incorporation stage itself or within six months of their incorporation. Companies incorporated after 30.9.2014 needs to have the resident director from the date of incorporation itself.

6. Independent Director

Board composition is one of the most important determinants of board effectiveness. Beyond the legal requirement of minimum directors, a board should have a judicious mix of internal and Independent Directors with a variety of experience and core competence. The potential competitive advantage of a Board structure comprising executive directors and independent non-executive directors lies in its combination of – the depth of knowledge of the business of the executives and the breadth of experience of the non-executive/independent director.

The word ‘independent’ with reference to board composition was used for the first time in corporate legislation in relation to investment companies by a Report that introduced the Investment Company Act, 1940. It suggested that at least 40 percent of the Board of directors of an investment company shall be Independent for safeguarding the investors.

In United Kingdom, in 1973, Lord Watkinson was appointed by Confederation
of British Industry to make recommendations on a more responsible corporate sector. He submitted his report titled ‘Responsibilities of the British Public Company’, which recommended appointment of non-executive directors to the Board.

**Role of Independent Director**

Independent directors are known to bring an objective view in board deliberations. They also ensure that there is no dominance of one individual or special interest group or the stifling of healthy debate. They act as the guardians of the interest of all shareholders and stakeholders, especially in the areas of potential conflict of interest.

Independent Directors bring a valuable outside perspective to the deliberations. They contribute significantly to the decision-making process of the Board. They can bring an objective view to the evaluation of the performance of Board and management. In addition, they can play an important role in areas where the interest of management, the company and shareholders may converge such as executive remuneration, succession planning, changes in corporate control, audit function etc.

Independent directors are required because they perform the following important role:

(i) Balance the often conflicting interests of the stakeholders.

(ii) Facilitate withstanding and countering pressures from owners.

(iii) Fulfills a useful role in succession planning.

(iv) Act as a coach, mentor and sounding board for their full time colleagues.

(v) Provide independent judgment and wider perspectives.

**Section 149(6) of Companies Act, 2013 defines independent director as below:**

An independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director,—

(a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

(b) (i) who is or was not a promoter of the company or its holding, subsidiary or associate company;

(ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

(c) who has or had no pecuniary relationship, other than remuneration as such director or having transaction not exceeding ten per cent. of his total income or such amount as may be prescribed, with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year; (This provision does not apply to Government Companies).

**Clarification by MCA**

1. whether a transaction entered into by an Independent Director with the company concerned at par with any member of the general public and at the same price as is payable/paid by such member of public would attract the bar of ‘pecuniary relationship’ under section 149(6)(c).

It has been clarified that in view of the provisions of section 188 which take away transactions in the ordinary course of business at arm’s length price from the purview of related party transactions, an Independent
Director will not be said to have 'pecuniary relationship', under section 149(6)(c) in such cases.

2. Whether receipt of remuneration, (in accordance with the provisions of the Act) by an Independent Director from a company would be considered as having pecuniary interest while considering his appointment in the holding company, subsidiary company or associate company of such company.

The matter has been examined in consultation with SEBI and it has been clarified that 'pecuniary relationship' provided in section 149(6)(c) of the Act does not include receipt of remuneration, from one or more companies, by way of fee provided under sub-section (5) of section 197, reimbursement of expenses for participation in the Board and other meetings and profit related commission approved by the members, in accordance with the provisions of the Act.

(d) none of whose relatives –

(i) is holding any security of or interest in the company, its holding, subsidiary or associate company during the two immediately preceding financial years or during the current financial year:

(ii) Provided that the relative may hold security or interest in the company of face value not exceeding fifty lakh rupees or two per cent. of the paid-up capital of the company, its holding, subsidiary or associate company or such higher sum as may be prescribed;

(iii) is indebted to the company, its holding, subsidiary or associate company or their promoters, or directors, in excess of such amount as may be prescribed during the two immediately preceding financial years or during the current financial year;

(iv) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, its holding, subsidiary or associate company or their promoters, or directors of such holding company, for such amount as may be prescribed during the two immediately preceding financial years or during the current financial year; or

(v) has any other pecuniary transaction or relationship with the company, or its subsidiary, or its holding or associate company amounting to two per cent. or more of its gross turnover or total income singly or in combination with the transactions referred to in sub-clause (i), (ii) or (iii);

(e) who, neither himself nor any of his relatives—

(i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

Provided that in case of a relative who is an employee, the restriction under this clause shall not apply for his employment during preceding three financial years.

(ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of—

(A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

(B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;
(iii) holds together with his relatives two per cent. or more of the total voting power of the company; or

(iv) is a Chief Executive or director, by whatever name called, of any nonprofit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or

(f) who possesses such other qualifications as may be prescribed.

Meaning of Independent Director under Regulation 16(1)(b) of SEBI (LODR) Regulations

The expression ‘independent director’ shall mean a non-executive director, other than a nominee director of the listed entity.

Effective from October 1, 2018. (b) "independent director" means a non-executive director, other than a nominee director of the listed entity:

(i) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

(ii) who is or was not a promoter of the listed entity or its holding, subsidiary or associate company or member of the promoter group of the listed entity;

(iii) who is not related to promoters or directors in the listed entity or its holding, subsidiary or associate company;

(iv) who, apart from receiving director's remuneration, has or had no material pecuniary relationship with the listed entity, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

(v) none of whose relatives has or had pecuniary relationship or transaction with the listed entity, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

(vi) who, neither himself nor any of his relatives —

(A) holds or has held the position of a key managerial personnel or is or has been employee of the listed entity or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

(B) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of —

(i) a firm of auditors or company secretaries in practice or cost auditors of the listed entity or its holding, subsidiary or associate company; or

(ii) any legal or a consulting firm that has or had any transaction with the listed entity, its holding, subsidiary or associate company amounting to ten per cent or more of the gross turnover of such firm;

(C) holds together with his relatives two per cent or more of the total voting power of the listed entity; or

(D) is a Chief Executive or director, by whatever name called, of any non-profit organisation that
receives twenty-five per cent or more of its receipts or corpus from the listed entity, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent or more of the total voting power of the company;

(E) is a material supplier, service provider or customer or a lessor or lessee of the company;

(vii) who is not less than 21 years of age.

(viii) who is not a non-independent director of another company on the board of which any non-independent director of the listed entity is an independent director.

Explanation — for the purposes of this section, “nominee director” means a director nominated by any financial institution in pursuance of the provisions of any law for the time being in force, or of any agreement, or appointed by any Government, or any other person to represent its interests.

Which Companies are required to appoint Independent Director?

Section 149(4) read with Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014 prescribed the companies which are required to appoint independent directors.

(1) Every company shall have a Board of Directors consisting of individuals as directors and shall have—

(a) a minimum number of three directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company; and

(b) a maximum of fifteen directors:

Provided that a company may appoint more than fifteen directors after passing a special resolution:

Provided further that such class or classes of companies as may be prescribed, shall have at least one woman director.

(2) Every company existing on or before the date of commencement of this Act shall within one year from such commencement comply with the requirements of the provisions of sub-section (1).

(3) Every company shall have at least one director who stays in India for a total period of not less than one hundred and eighty-two days in the calendar year.

Provided that in case of a newly incorporated company the requirement under this sub-section shall apply proportionately at the end of the financial year in which it is incorporated.

(4) Every listed public company shall have at least one-third of the total number of directors as independent directors and the Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies.

Explanation.—For the purposes of this sub-section, any fraction contained in such one-third number shall be rounded off as one.

Further, as per Section 151 of the Companies Act, 2013, a listed company may have one director elected by such small shareholders in such manner and with such terms and conditions as may be prescribed.

Explanation- For the purpose of this section “small shareholders” means a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed.
Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014 prescribes provisions related to appointment of small shareholders’ director.

However, the provision of independent director shall not apply to Section 8 companies, specified IFSC public companies, unlisted public companies which are joint venture or wholly owned subsidiary or dormant company.

Regulation 24 of SEBI (LODR) Regulations, 2015 (as amended) provide that at least one independent director on the board of directors of the listed entity shall be a director on the board of directors of an unlisted material subsidiary, whether incorporated in India or not.

For the purposes of this provision, notwithstanding anything to the contrary contained in regulation 16, the term “material subsidiary” shall mean a subsidiary, whose income or net worth exceeds twenty percent of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year.

What are the Qualifications of an Independent Director?

Rule 5 of Companies (Appointment and Qualification of Directors) Rules, 2014 provides that an independent director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company’s business.

In Schedule V of SEBI (LODR), 2015 it has been provided that a chart or a matrix setting out the skills/expertise/competence of the board of directors specifying the following shall be furnished in the Corporate Governance Report:

- With effect from the financial year ending March 31, 2019, the list of core skills/expertise/competencies identified by the board of directors as required in the context of its business(es) and sector(s) for it to function effectively and
- those actually available with the board; and
- With effect from the financial year ended March 31, 2020, the names of directors who have such skills/expertise/competence and confirmation that in the opinion of the board, the independent directors fulfill the conditions specified in these regulations and are independent of the management.

What is the Manner of selection of an Independent Director?

According to section 150(1) of the Act, independent directors may be selected from a data bank of eligible and willing persons maintained by the agency (any body, institute or association as may be authorised by Central Government). Such agency shall put data bank of independent directors on the website of Ministry of Corporate Affairs or any other notified website.

The Independent Directors Repository is a joint initiative of the three professional statutory bodies, namely, ICAI, ICSI and ICoAI under the active encouragement of the MCA. This repository has been developed to facilitate the individuals who are eligible and willing to act as Independent Directors and also to facilitate Companies to select the persons who are eligible and willing to act as Independent Directors. This repository is available at https://independentdirector.in/

Company must exercise due diligence before selecting a person from the data bank referred to above, as an independent director.

This section further stipulates that the appointment of independent directors has to be approved by members
in a General meeting and the explanatory statement annexed to the notice must indicate justification for such appointment.

Any person who desires to get his name included in the data bank of independent directors shall make an application to the agency for inclusion of name in the databank of Independent Directors which includes the personal, educational, professional, work experience, other Board details of the applicant (Rule 6(4)].

The agency may charge a reasonable fee from the applicant for inclusion of his name in the data bank of independent directors (Rule 6 (5)]

An existing or applicant of such data bank of independent directors shall intimate any changes in his particulars within fifteen days of such change to the agency (Rule 6 (6)].

Rule 6(7) prescribed that the databank posted on the website shall:

- be accessible at the specified website;
- be substantially identical to the physical version of the data bank;
- be searchable on the parameters specified in rule 6 (2);
- be presented in a format or formats convenient for both printing and viewing online; and
- contain a link to obtain the software required to view print the particulars free of charge.

The Institute of Chartered Accountants of India, The Institute of Company Secretaries of India and the Institute of Cost Accountants of India under the active encouragement of Ministry of Corporate Affairs, Government of India has developed Independent Directory Repository to facilitate Companies to select the persons who are eligible and willing to act as Independent Directors.

**What is Declaration of Independence?**

A statement/declaration by an independent director that he meets the criteria of independence is a good governance practice. Companies are encouraged to obtain such a certificate at the time of appointment as well as annually. There is always a possibility that independent director losses his independent status while holding his office. In such a situation the director must approach the Board and communicate his status. In turn, the company is expected to make adequate disclosures to the shareholders.

Section 149(7) of Companies Act, 2013 states that every independent director shall at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the circumstances which may affect his status as an independent director, give a declaration that he meets the criteria of independence.

Vide SEBI (LODR) Regulations, 2015 every independent director shall, at the first meeting of the board in which he participates as a director and thereafter at the first meeting of the board in every financial year or whenever there is any change in the circumstances which may affect his status as an independent director, submit a declaration that he meets the criteria of independence as provided in clause (b) of sub-regulation (1) of 12 regulation 16 and that he is not aware of any circumstance or situation, which exist or may be reasonably anticipated, that could impair or impact his ability to discharge his duties with an objective independent judgment and without any external influence. The BoD of the listed entity is now required to take on record the declaration and confirmation submitted by the independent director under sub-regulation (8) after undertaking due assessment of the veracity of the same.
What is Code for Independent Director?

Sub-section (8) of Section 149 provides that the independent directors shall abide by the provisions specified in Schedule IV. It is a guide to professional conduct for independent directors. Adherence to these standards by independent directors and fulfillment of their responsibilities in a professional and faithful manner will promote confidence of the investment community, particularly minority shareholders, regulators and companies in the institution of independent directors.

It provides guidelines for professional conduct, roles, functions and duties, manner of appointments and reappointments, resignation/removal, separate meetings and evaluation mechanism.

What is the Tenure of an Independent Director?

The tenure of an independent director affects his independence. An independent director with "externality" may lose his independence or may become not so independent due to rapport established with the internal directors and the management. It is therefore necessary to limit the tenure of an independent director. Excessively long tenure of independent directors reflects: Closeness of the relationship between the independent director and management and lack of Board renewal.

As per proviso 10 to Section 149 of the Companies Act, 2013, subject to provisions of Section 152, an independent director shall hold office for a term up to five consecutive years on the Board of a company and shall be eligible for reappointment for another term of up to five consecutive years on passing of a special resolution by the company.

Provided that a person who has already served as an independent director for five years or more in a company as on October 1, 2014 shall be eligible for appointment, on completion of his present term, for one more term of up to five years only.

Provided further no independent director shall hold office for two consecutive terms but shall be eligible for appointment as independent director after the expiration of three years of ceasing to be an independent director in the company. [Section 149(11)]

As per SEBI (LODR) Regulations the maximum tenure of independent directors shall be in accordance with the Companies Act, 2013 and rules made there under, in this regard, from time to time.

Detailed reasons for the resignation of an independent director who resigns before the expiry of his tenure along with a confirmation by such director that there are no other material reasons other than those provided have to be disclosed in the Corporate Governance Report of a Listed entity under SEBI (LODR), 2015.

As per Schedule IV of the Companies Act, 2013 an independent director who resigns or is removed from the Board of the company shall be replaced by a new independent director within three months from the date of such resignation or removal, as the case may be.

Clarifications by MCA:

Can independent directors appointed prior to April 1, 2014 continue and complete their remaining tenure, under the provisions of the Companies Act, 1956 or they should demit office and be re-appointed (should the company so decide) in accordance with the provisions of the new Act.

Explanation to section 149(11) clearly provides that any tenure of an independent director on the date of commencement of the Act shall not be counted for his appointment/ holding office of director under the Act. In view of the transitional period of one year provided under section 149(5), It has been clarified that it would
be necessary that if it is intended to appoint existing independent directors under the new Act, such appointment shall be made expressly under section 149(10)/(11) read with Schedule IV of the Act within one year from 1st April, 2014, subject to compliance with eligibility and other prescribed conditions.

Whether it would be possible to appoint an individual as an ID for a period less than five years.

It has been clarified that section 149(10) of the Act provides a term of "up to five consecutive years" for an Independent Director. As such while appointment of an ‘ID’ for a term of less than five years would be permissible, appointment for any term (whether for five years or less) is to be treated as a one term under section 149(10) of the Act. Further, under section 149(11) of the Act, no person can hold office of independent director for more than 'two consecutive terms'. Such a person shall have to demit office after two consecutive terms even if the total number of years of his appointment in such two consecutive terms is less than 10 years. In such a case the person completing 'consecutive terms of less than ten years' shall be eligible for appointment only after the expiry of the requisite cooling-off period of three years.

What are the provisions relating to remuneration of independent Directors?

Section 149(9) provides that notwithstanding anything contained in any other provision of this Act, but subject to the provisions of sections 197 and 198, an independent director shall not be entitled to any stock option and may receive remuneration by way of fee provided under sub-section (5) of section 197, reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members.

How to evaluate Performance of an Independent director?

Section 178(2) read with Schedule IV: 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 specify the manner for effective evaluation of performance of Board, its committees and individual directors to be carried out either by the Board, by the Nomination and Remuneration Committee or by an independent external agency and review its implementation and compliance. The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated. 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.

Regulation 17(10) of SEBI LODR Regulations also provide that the evaluation of independent directors shall be done by the entire board of directors which shall include:

(a) performance of the directors; and

(b) fulfillment of the independence criteria as specified in these regulations and their independence from the management:

Provided that in the above evaluation, the directors who are subject to evaluation shall not participate.

What is the Legal position of an Independent Director?

Independent directors are invited to sit on the board purely on account of their special skills and expertise in particular fields and they represent the conscience of the investing public and also take care of public interest. Independent directors bear a fiduciary responsibility towards shareholders and the creditors. The company and the board are responsible for all the consequences of actions taken by the officers of the company.
As per Section 149(12), notwithstanding anything contained in this Act, an independent director; shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.

Further, Section 149(13) states that the provisions of sections 152(6) & (7) in respect of retirement of directors by rotation shall not be applicable to appointment of independent directors. In case of specified IFSC Public Company Clause (i) of sub-section (12) and Sub-section (13) of Section 149 shall not apply.

**Term of Office**

An independent director shall hold office for a term up to five consecutive years on the Board of a company and shall be eligible for reappointment for another term of up to five consecutive years on passing of a special resolution by the company.

Provided that a person who has already served as an independent director for five years or more in a company as on October 1, 2014 shall be eligible for appointment, on completion of his present term, for one more term of up to five years only.

Provided further that an independent director, who completes his above mentioned term shall be eligible for appointment as independent director in the company only after the expiration of three years of ceasing to be an independent director in the company.

**Removal of Independent director re-appointed for second term**

An independent director can be re-appointed for second term only by way of a special resolution, such independent director can be removed only by a special resolution and after giving him a reasonable opportunity of being heard.

**Limit on number of directorships**

As per Regulation 25 of (LODR) Regulation:

a. A person shall not serve as an independent director in more than seven listed companies.

b. Further, any person who is serving as a whole time director in any listed company shall serve as an independent director in not more than three listed companies.

As per Regulation 17A of (LODR) Regulation:

The directors of listed entities shall also comply with the following conditions with respect to the maximum number of directorships, including any alternate directorships that can be held by them at any point of time –

(1) A person shall not be a director in more than eight listed entities with effect from April 1, 2019 and in not more than seven listed entities with effect from April 1, 2020

Provided that a person shall not serve as an independent director in more than seven listed entities.

(2) Notwithstanding the above, any person who is serving as a whole time director / managing director in any listed entity shall serve as an independent director in not more than three listed entities.

For the purpose of this sub-regulation, the count for the number of listed entities on which a person is a director/independent director shall be only those whose equity shares are listed on a stock exchange.
The company shall also issue a formal letter of appointment to independent directors in the manner as provided in the Companies Act, 2013. The letter of appointment along with the detailed profile of independent director shall be disclosed on the websites of the company.

**Separate meetings of the Independent Directors**

a. The independent directors of the company shall hold at least one meeting in a financial 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.

b. The independent directors in the meeting shall, inter-alia:
   i. review the performance of non-independent directors and the Board as a whole;
   ii. review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;
   iii. 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.

**Familiarisation Program for Independent Directors**

The listed entity shall familiarise the independent directors through various programmes about the listed entity, including the following:

a. nature of the industry in which the listed entity operates;

b. business model of the listed entity;

c. roles, rights, responsibilities of independent directors; and

d. any other relevant information

**Liability of the Independent Director**

An independent director shall be held liable, only in respect of such acts of omission or commission by the listed entity which had occurred with his knowledge, attributable through processes of board of directors, and with his consent or connivance or where he had not acted diligently with respect to the provisions contained in these regulations.

A new requirement for top 500 listed entities to undertake Directors and Officers (D and O) Insurance for all their independent directors of such quantum and for such risks as may be determined by its board of directors. Market capitalization would be calculated as on 31 March of the preceding financial year for determining top 500 listed entities. Companies will need to comply with the D and O Insurance requirement with effect from 1 October 2018. (SEBI LODR)

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**CASE STUDIES**

Securities Exchange Commission, USA, in a recent case has begun a new era of scrutinizing liability of independent directors by bringing an action against independent director. In SEC v. Raval, Civil Action No. 8:10-cv-00101 (D.Neb. filed Mar.15,2010) it was alleged that Vasant Raval, former Chairman of the Audit Committee of InfoGroup Inc.(now InfoUSA, Inc.) had failed to sufficiently investigate certain “red flags” surrounding the company’s former CEO and Chairman of the Board, Vinod Gupta.

The SEC’s complaint alleged that Vasant Raval 70, resident of Nebraska, served on the board of directors.
for InfoGroup in various positions from 2003 to 2008, including a stint as Chairman of the Audit Committee. During this period, Raval allegedly turned a blind eye to allegations that Vinod Gupta directed the company to improperly pay himself $9.5 million that he then spent on corporate jets, service for his yacht, life insurance premiums, and payment of personal credit cards. In addition, the complaint alleged that Gupta directed the company to enter into related party transactions totaling approximately $9.3 million with entities that he controlled or with whom he was affiliated viz. Annapurna Corporation (now Everest Corporation), Aspen Leasing Services, LLC ("Aspen Leasing"). These related party transactions were not disclosed in the company's public filings.

The Commission also alleged that Raval failed to respond appropriately to various red flags concerning Gupta's expenses and Info's related party transactions with Gupta's entities. According to the complaint, Raval failed to take appropriate action regarding the concerns expressed to him by two internal auditors of Infogroup Inc., that Gupta was submitting requests for reimbursement of personal expenses. In a board meeting, Raval was tasked with investigating the propriety of the transactions. Rather than seeking assistance from outside counsel or rigorously scrutinizing the transactions, Raval began his "in depth investigation" and presented a report to the company's board merely in 12 days. The "Raval Report" however, omitted critical facts.

Despite numerous prompts by internal auditor, Raval failed to undertake a thorough investigation. As a result, the company allegedly failed to disclose related party transactions and materially understated Gupta's compensation. Although Raval did not make any pecuniary benefits, he failed to discharge his duties and take meaningful action to further investigate Gupta's misconduct and misappropriation of company funds.

The SEC charged Raval for failing in his 'affirmative responsibilities' and thus violating the anti-fraud, proxy, and reporting provisions of the US Exchange Act. To settle his case, Raval consented to the entry of a permanent injunction prohibiting future violations of the related provisions of the federal securities laws, a $50,000 civil penalty, and a five-year ban from serving as an officer or director of a company.

**Indian scenario**

In Bhopal Gas Tragedy verdict, the Bhopal Trial Court on 7th June 2010 has held Keshub Mahindra reputed industrialist, the then non executive chairman of Union Carbide India limited(UCIL), guilty and sentenced him to two years of imprisonment along with seven others accused. He was charged of attending only a few meetings in a year and took only macro view of the company's developments. A non-vigilant act of non-executive chairman, accounted for death of thousands. "Ignorance" of the system by the director of the company is unacceptable. Role of non executive director in this case is questionable. Later he was granted bail.

7. **Nominee Director**

A nominee director belongs to the category of non-executive director and is appointed on behalf of an interested party.

It is pertinent to mention here that there is a divergent view as to whether a nominee director can be considered independent or not. Naresh Chandra Committee in its report stated that ‘nominee director’ will be excluded from the pool of directors in the determination of the number of independent directors. In other words, such a director will not feature either in the numerator or the denominator.

Both Listing Obligations and section 149(6) of the Companies Act, 2013 specifically exclude nominee director from being considered as Independent.

8. **Lead Independent Director**

Internationally, it is considered a good practice to designate an independent director as a lead independent
director or senior independent director. He coordinates the activities of other non-employee directors and advises the chairman on issues ranging from the schedule of board meetings to recommending retention of advisors and consultants to the management.

- Acts as the principal liaison between the independent directors of the Board and the Chairman of the Board;
- Develops the agenda for and preside at executive sessions of the Board’s independent directors;
- Advises the Chairman of the Board as to an appropriate schedule for Board meetings, seeking to ensure that the independent directors can perform their duties responsibly while not interfering with the flow of Company operations;
- Approves with the Chairman of the Board the agenda for Board and Board Committee meetings and the need for special meetings of the Board;
- Advises the Chairman of the Board as to the quality, quantity and timeliness of the information submitted by the Company’s management that is necessary or appropriate for the independent directors to effectively and responsibly perform their duties;
- Recommends to the Board the retention of advisors and consultants who report directly to the Board;
- Interviews, along with the chair of the Nominating and Corporate Governance Committee, all Board candidates, and make recommendations to the Nominating and Corporate Governance Committee;
- Assists the Board and Company officers in better ensuring compliance with and implementation of the Governance Guidelines;
- Serves as Chairman of the Board when the Chairman is not present; and
- Serves as a liaison for consultation and communication with shareholders.

California Public Employees' Retirement System (CalPERS) provides that where the Chairman of the board is not an independent director, and the role of Chairman and CEO is not separate, the board should name a director as lead independent director who should have approval over information flow to the board, meeting agendas, and meeting schedules to ensure a structure that provides an appropriate balance between the powers of the CEO and those of the independent directors.

Other roles of the lead independent director should include chairing meetings of non-management directors and of independent directors, presiding over board meetings in the absence of the chair, serving as the principle liaison between the independent directors and the chair, and leading the board/director evaluation process. Given these additional responsibilities, the lead independent director is expected to devote a greater amount of time to board service than the other directors.

9. Chairman

The responsibility for ensuring that boards provide the leadership which is expected of them is that of their chairman. Chairmen, however, have no legal position; they are whoever the board elects to take the chair at a particular meeting. Boards are not bound to continue with the same chairman for successive meetings. In law, all directors have broadly equal responsibilities and chairmen are no more equal than any other board member. Chairmen are an administrative convenience and a means of ensuring that board meetings are properly conducted.

Thus from a statutory point of view there is no necessity for a board to have a continuing chairman. The chairmanship could, for example, rotate among board members. Although board chairmen have no statutory
position, the choice of who is to fill that post is crucial to board effectiveness. If the chairman is not up to the task, it is improbable that the meeting will achieve anything but frustration and waste of that most precious of resources—time. Continuity and competence of chairmanship is vital to the contribution which boards make to their companies. The leaders which boards give to their companies, stems from the leadership which chairmen give to their boards.

The Chairman's primary responsibility is for leading the Board and ensuring its effectiveness.

The role of the Chairman includes:

→ setting the Board agenda, ensuring that Directors receive accurate, timely and clear information to enable them to take sound decisions, ensuring that sufficient time is allowed for complex or contentious issues, and

→ encouraging active engagement by all members of the Board;

→ taking the lead in providing a comprehensive, formal and tailored induction programme for new Directors, and in addressing the development needs of individual Directors to ensure that they have the skills and knowledge to fulfill their role on the Board and on Board Committees;

→ evaluating annually the performance of each Board member in his/her role as a Director, and ensuring that the performance of the Board as a whole and its Committees is evaluated annually. Holding meetings with the non executive Directors without the executives being present;

→ ensuring effective communication with shareholders and in particular that the company maintains contact with its principal shareholders on matters relating to strategy, governance and Directors' remuneration. Ensuring that the views of shareholders are communicated to the Board as a whole.

The main features of the role of chairman are as follows:

→ Being chairman of the board, he/she is expected to act as the company's leading representative which will involve the presentation of the company's aims and policies to the outside world;

→ to take the chair at general meetings and at board meetings. With regard to the latter this will involve;

→ the determination of the order of the agenda;

→ ensuring that the board receives proper information;

→ keeping track of the contribution of individual directors and ensuring that they are all involved in discussions and decision making. At all meetings the chairman should direct discussions towards the emergence of a consensus view and sum up discussions so that everyone understands what has been agreed;

→ to take a leading role in determining the composition and structure of the board. This will involve regular reviews of the overall size of the board, the balance between executive and non-executive directors and the balance of age, experience and personality of the directors (diversity).

The chairman is responsible for leadership of the board, ensuring its effectiveness on all aspects of its role and setting its agenda. The chairman is also responsible for ensuring that the directors receive accurate, timely and clear information. The chairman should ensure effective communication with shareholders. The chairman should also facilitate the effective contribution of non-executive directors in particular and ensure constructive relations between executive and non-executive directors.
With the changing requirements, it has also become imperative for a Chairman to ensure that all the directors are made aware of their responsibilities through a tailored induction programme. Also he/she should ensure that the directors play a full and constructive role in the affairs of the company; and take a lead role in the process of removing non-performing or unsuitable directors.

King III recommended that the Chairperson should be an independent non-executive director and the Chairperson should also not be a CEO. While the Chairperson is required to retain an objective viewpoint of the affairs of the Company, the CEO is often required to become intimately involved in developing and executing management plans for the company. The independence of the Chairman is paramount to the successful implementation of good corporate governance practices at the board level. Most of the internationally accepted codes of governance say that Chairperson should not have previously been the CEO of the Company. In German corporate law, the role of the independent (non-executive) director is emphasized by the legislative provision that precludes employees (executives) from serving the boards of the companies. The Chairperson of the Board should be independent and free of conflict of interest.

First proviso to Section 203 of the Companies Act, 2013 provides for the separation of role of Chairman and Chief Executive Officer subject to conditions thereunder.

Regulation 17(1)(b) of SEBI (LODR) Regulations further provides that in case the Chairman of the board in a non-executive director, at least one-third of the Board should comprise independent directors and in case where the listed entity does not have a regular non-executive Chairman, at least half of the Board should comprise independent directors.

Further the listed entity shall not appoint a person or continue the directorship of any person as a non-executive director who has attained the age of seventy five years unless a special resolution is passed to that effect, in which case the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such a person.

With effect from April 1, 2020, the top 500 listed entities shall ensure that the chairperson of the board of such listed entity shall –

(a) be a non-executive director;
(b) not be related to the Managing Director or
the Chief Executive Officer as per the definition of the term “relative” defined under the Companies Act, 2013.

This sub regulation shall not be applicable to the listed entities which do not have any identifiable promoters as per the shareholding pattern filed with stock exchanges.

The top 500 entities shall be determined on the basis of market capitalisation, as at the end of the immediate previous financial year.

As per the Institute of Directors (IOD) (UK), the following are the responsibilities of a chairman

The chairman’s primary role is to ensure that the board is effective in its tasks of setting and implementing the company’s direction and strategy.

The chairman is appointed by the board and the position may be full-time or part time. The role is often combined with that of managing director or chief executive in smaller companies. However, the joint role is considered to be less appropriate for public companies listed on the Stock Exchange.
10. Chief Executive Officer (CEO)

The Board appoints the CEO based on the criterion of his capability and competence to manage the company effectively. His main responsibilities include developing and implementing high-level strategies, making major corporate decisions, managing the overall operations and resources of a company, and acting as the main point of communication between the board of directors and the corporate operations. He is involved with every aspect of the company’s performance. The CEO is supported and advised by a skilled board and CEO is ultimately accountable to the board for his actions. The most important skill of a CEO is to think strategically. His key role is leading the long term strategy and its implementation, it further includes:

→ Developing implementation plan of action to meet the competition and keeping in mind the long term existence of the company
→ Adequate control systems
→ Monitoring the operating and financial outcomes against the set plan
→ Remedial action
→ Keeping the Board informed

CEO should be able to, by the virtue of his ability, expertise, resources and authority keep the company prepared to avail the benefit of any change whether external or internal.

Separation of role of Chairman and Chief Executive Officer

It is perceived that separating the roles of chairman and chief executive officer (CEO) increases the effectiveness of a company’s board. This is also provided in the Section 203 of the Companies Act, 2013.

It is the board’s and chairman’s job to monitor and evaluate a company’s performance. A CEO, on the other hand, represents the management team. If the two roles are performed by the same person, then it’s an individual evaluating himself. When the roles are separate, a CEO is far more accountable.

A clear demarcation of the roles and responsibilities of the Chairman of the Board and that of the Managing Director/CEO promotes balance of power. The benefits of separation of roles of Chairman and CEO can be:

1. Director Communication: A separate chairman provides a more effective channel for the board to express its views on management
2. Guidance: A separate chairman can provide the CEO with guidance and feedback on his/her performance
3. Shareholders’ interest: The chairman can focus on shareholder interests, while the CEO manages the company
4. Governance: A separate chairman allows the board to more effectively fulfill its regulatory requirements
5. Long-Term Outlook: Separating the position allows the chairman to focus on the long-term strategy while the CEO focuses on short-term profitability
6. Succession Planning: A separate chairman can more effectively concentrate on corporate succession plans.
11. Company Secretary

As per Section 2(24) of the Companies Act, 2013, “company secretary” or “secretary” means a company secretary as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 who is appointed by a company to perform the functions of a company secretary under this Act;

Under Section 2(60) of the Companies Act, 2013, the company secretary has also been included in the category of the officer of the company and shall be considered to be in default in complying with any provisions of the Companies Act, 2013.

A Company Secretary, being a close confidante of the board will also be able to command confidence of individual directors so as to ensure that the culture of independence is promoted at the board and committee meetings and at the level of individual directors. Company Secretary:

- acts as a vital link between the company and its Board of Directors, shareholders and other stakeholders and regulatory authorities
- plays a key role in ensuring that the Board procedures are followed and regularly reviewed
- provides the Board with guidance as to its duties, responsibilities and powers under various laws, rules and regulations
- acts as a compliance officer as well as an in-house legal counsel to advise the Board and the functional departments of the company on various corporate, business, economic and tax laws
- is an important member of the corporate management team and acts as conscience keeper of the company

Section 2(51) of the Companies Act, 2013 defines KMP as

“Key managerial personnel”, in relation to a company, means —

- the Chief Executive Officer or the managing director or the manager;
- the company secretary;
- the whole-time director;
- the Chief Financial Officer;
- such other officer, not more than one level below the directors who is in whole-time employment, designated as key managerial personnel by the Board; and
- such other officer as may be prescribed.

- In the light of provisions of Section 2(60) of Companies Act, 2013 Company Secretary is also an officer in default.

Functions and Duties of a Company Secretary

Section 205 of the Companies Act, 2013 prescribes that the functions of the company secretary shall include,—

(a) to report to the Board about compliance with the provisions of this Act, the rules made thereunder and other laws applicable to the company;

(b) to ensure that the company complies with the applicable secretarial standards;
(c) to discharge such other duties as may be prescribed.

Explanation—For the purpose of this clause, the expression “secretarial standards” means secretarial standards issued by the Institute of Company Secretaries of India and approved by the Central Government.

Further, Rule 10 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014:

- To guide the directors of the company regarding their duties, responsibilities and powers
- To facilitate the convening of meetings
- To attend Board Meetings, Committee Meetings and General Meetings
- To maintain minutes of the meetings
- To obtain the approvals from Board, General Meeting, Government and other authorities as required
- To represent before various regulators, and other authorities
- To assist the Board in the conduct of affairs of the company
- To assist and advise the Board in ensuring good corporate governance
- To assist and advise the Board in ensuring the compliance of corporate governance requirements and best practices
- To discharge such other duties as specified under the Act or rules
- To discharge such other duties as may be assigned by the Board from time to time

Appointment of Company Secretary

Section 203(2) of Companies Act, 2013 provides that every whole-time key managerial personnel of a company shall be appointed by means of a resolution of the Board containing the terms and conditions of the appointment including the remuneration.

Rule 8 and 8A of companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014

Rule 8 – Every listed company and every public company having paid up capital of 10 crore or more rupees shall have whole-time Key Managerial personnel.

Rule 8A – Companies other than covered under rule 8 which has paid up capital of 5 crore or more shall have a whole-time Company Secretary.

The Financial Aspects of Corporate Governance 1992 (Cadbury Report) provides that the company secretary has a key role to play in ensuring that board procedures are both followed and regularly reviewed. The chairman and the board will look to the company secretary for guidance on what their responsibilities are under the rules and regulations to which they are subject and on how those responsibilities should be discharged. All directors should have access to the advice and services of the company secretary and should recognise that the chairman is entitled to the strong and positive support of the company secretary in ensuring the effective functioning of the board. It should be standard practice for the company secretary to administer, attend and prepare minutes of board proceedings.

UK Corporate Governance Code 2016 provides that the company secretary’s responsibilities include ensuring good information flows within the board and its committees and between senior management and non executive directors, as well as facilitating induction and assisting with professional development as
required. The company secretary should be responsible for advising the board through the chairman on all governance matters.

*King IV Report on Corporate Governance for South Africa, 2016*

**PRINCIPLE 10: Professional corporate governance services to the governing body**

The governing body should ensure that it has access to professional and independent guidance on corporate governance and its legal duties, and also that it has support to coordinate the functioning of the governing body and its committees.

For some companies, the appointment of a company secretary is a statutory requirement. In respect of those companies, the company secretary provides professional corporate governance services. The governing body of an organisation not so obliged should, as a matter of leading practice, consider appointing a company secretary or other professional, as is appropriate for the organisation, to provide professional corporate governance services to the governing body.

The governing body should approve the arrangements for the provision of professional corporate governance services, including whether to outsource them to a juristic person, or to make a full-time or part-time appointment.

Regardless of the arrangements it has approved, the governing body should ensure that the office of the company secretary or other professional providing corporate governance services, is empowered and that the position carries the necessary authority.

The governing body should approve the appointment, including the employment contract and remuneration of the company secretary or other professional providing corporate governance services. The governing body should oversee that the person appointed has the necessary competence, gravitas and objectivity to provide independent guidance and support at the highest level of decision-making in the organisation.

The governing body should have primary responsibility for the removal of the company secretary or other professional providing corporate governance services.

The company secretary or other professional providing corporate governance services should have unfettered access to the governing body but, for reasons of independence, should maintain an arms-length relationship with it and its members; accordingly, the company secretary should not be a member of the governing body.

The company secretary or other professional providing corporate governance services should report to the governing body via the chair on all statutory duties and functions performed in connection with the governing body. Regarding other duties and administrative matters, the company secretary or other professional providing corporate governance services should report to the member of executive management designated for this purpose as is appropriate for the organisation.

The performance and independence of the company secretary or other professional providing corporate governance services should be evaluated at least annually by the governing body.

The arrangements in place for accessing professional corporate governance services and a statement on whether the governing body believes those arrangements are effective should be disclosed.
SEGMENT II

BOARD CHARTER

As a good practice companies may have a Board Charter which is intended as a tool to assist directors in fulfilling their responsibilities as Board members. It sets out the respective roles, responsibilities and authorities of the Board and of Management in the governance, management and control of the organization. This charter should be read in conjunction with the Company’s Memorandum and Articles.

A Model Charter may include the following:

The Role of the Board

The principal functions and responsibilities of the Board relating to

- Strategies
- Corporate Governance
- Financial Management
- Relationship with Senior Management

The Role of the Chairman

The Role of the CEO

The Role of the Company Secretary

Directors Code of Conduct

Conflicts of Interests

Related Party transactions

Board Members Qualifications, skills

Board Meetings

Delegation of Authority by the Board

- Role & power of Committees
- Committee Meetings

Protocol for media contact and comment

Hospitality and Gifts-- not solicit such courtesies and not accept gifts, services, benefits or hospitality that might influence, or appear to influence, the Directors’ conduct in representing the Company.

Board Evaluation

Directors liability insurance

Director Induction

Non-Executive Director Remuneration

Reimbursement of expenses
BOARD PROCESSES THROUGH SECRETARIAL STANDARDS

It is important to consider elements of board processes that contribute to the effective & efficient performance of the Board. Secretarial Standards are a codified set of good governance practices which seek to integrate, harmonize and standardize the diverse secretarial practices followed by companies with respect to conduct of Meetings and play indispensable role in enhancing the corporate culture and governance across the organisations.

Board Meetings

Decisions relating to the policy and operations of the company are arrived at meetings of the Board held periodically. Meetings of the Board enable discussions on matters placed before them and facilitate decision making based on collective judgment of the Board. This requires certain businesses to be approved at meetings of the Board only.

The fundamental principles with respect to Board Meetings are laid down in the Act. SS-1 facilitates compliance with these principles by endeavouring to provide further clarity where there is ambiguity and establishing benchmark standards to harmonise prevalent diverse practices. For the benefit of companies, SS-1 provides necessary flexibility in many cases viz. with respect to calling Meeting at shorter notice, transacting any other business not contained in the agenda and passing of Resolutions by circulation. Complying with SS-1 ensures a reliable Board process which protects the interests of the company and its stakeholders. Incidentally, it has been observed that the quantum and propensity for litigations or risk thereof is directly proportional to the degree of non-adherence to proper procedures and the non-availability of proper records, especially in the case of small and private companies. The objective of SS-1 is to address such issues.

SS-1 requires Company Secretary(ies) to oversee the vital process of recording and facilitating implementation of the decisions of the Board. Where there is no Company Secretary in the company or in the absence of the Company Secretary, any Director or other Key Managerial Personnel (KMP) or any other person authorised by the Board for this purpose may discharge such of the functions of the Company Secretary as given in SS-1.

Good Practices in Convening Board Meetings

→ Annual Calendar

An Annual calendar that schedules the Board and committee meetings and accordingly dates by which action required is accomplished is an effective planner for the year. The planner schedules in advance the events so that both the providers of inputs and receivers of inputs can plan their work systematically.

→ Meeting Location

The board meetings should take place at a venue that is convenient to the directors (normally the head office). Boards are increasingly holding at least one board meeting at other company locations so that directors can see the other sites.

→ Board Meeting Frequency

Board meetings should be held regularly, at least four times in a year, with a maximum interval of 120 days between meetings.

As a rule of thumb and in line with best practice, six to ten meetings are likely to constitute an appropriate
number of board meetings per year, particularly when committees meet between board sessions.

→ Board Agenda

Preparation of Agenda

The board agenda determines the issues to be discussed. The items for agenda should be collected from heads of all the departments. Secretary may segregate the ones that can be discussed and decided internally and the ones which need to be put up before the Board, in consultation with the Chairman and/or Managing Director and inputs from the CEO.

Any director can request that the chairman include a matter on the board agenda. It is the chairman’s prerogative to offer directors the opportunity to suggest items, which cannot be reasonably denied. In the end, it is each director’s responsibility to ensure that the right matters are tabled.

Key success factors for setting the agenda include:

Agendas should strike a balance between reviews of past performance and forward-looking issues.

Strategic issues require more time for debate so it is a good practice that the allocated discussion time is indicated in the agenda.

Some issues will need to be brought to the board several times as projects progress and circumstances develop.

Factors to keep in mind

- Care should be taken not to consume too much board time on routine or administrative matters.
- The agenda should show the amount of time allocated for each item, without unduly restricting discussion.

Circulation of Notice & Agenda

Notice

Even if meetings have been scheduled in advance, the members of the Board should be adequately and timely sent notice to enable them to plan accordingly. The Companies Act, 2013 as well as the Secretarial Standards provides that the notice of Board Meeting shall be sent at least 7 days before the meeting.

Agenda

The agenda should be made available to the Board along with supporting papers at least seven days in advance of the date of the meeting. The mode of circulation of agenda should ensure that all directors receive the agenda notes on time. All the material information should be sent to all Directors simultaneously and in a timely manner to enable them to prepare for the Board Meeting. This would enable the board and especially to non-executive and independent directors to prepare for the discussions based on the papers.

A system should exist for seeking and obtaining further information and clarifications on the agenda items before the meeting. Directors, including nominee directors, requiring any clarification before the meeting may be asked to contact the Secretary for additional inputs.
Board Briefing Papers

Board materials should be summarized and formatted so that board members can readily grasp and focus on the most significant issues in preparation for the board meeting. It is not necessary that more information means better quality. If relevant and complete information is presented in an orderly manner will be more useful than a bulky set of documents which has been put together without any order.

The Papers for Board meetings should be:

- Short. Board papers associated with a particular agenda item should be set out as an executive summary with further detail provided in annexures.
- Timely. Information should be distributed at least seven business days before the meeting.

**Focused and action-oriented.** The papers should present the issue for discussion, offer solutions for how to effectively address the issue, and provide management’s view on which action to take.

If a proposal is more complex or requires additional explanation, the board should consider delegating the matter to a board committee or seek a detailed discussion or require an appraisal by an outside independent expert.

Directors should inform the chairman if the information they receive is insufficient for making sound decisions and monitoring responsibilities effectively.

The Information Requirements for Board Meetings

These requirements will vary among companies. In general, directors should expect to receive the following regular items at least seven days before the board meeting:

- An agenda.
- Minutes from last meeting along with action taken report.
- Minutes of Committee Meetings.
- Information of the statutory compliances of the laws applicable to the company.
- Papers relating to specific agenda items.

Provisions Regarding Meetings of the Board

Meetings of the Board: Section 173 of Companies Act, 2013

Section 173 of the Act deals with Meetings of the Board.

1. The Act provides that the first Board meeting should be held within thirty days of the date of incorporation.

2. In addition to the first meeting to be held within thirty days of the date of incorporation, there shall be minimum of four Board meetings every year and not more one hundred and twenty days shall intervene between two consecutive Board meetings.

3. In case of One Person Company (OPC), small company and dormant company, at least one Board meeting should be conducted in each half of the calendar year and the gap between two meetings should not be less than Ninety days.

4. The specified IFSC companies shall hold the first meeting of the Board of Directors within
sixty days of its incorporation and thereafter hold at least one meeting of the Board of Directors in each half of a calendar year.” (Notification Dated 4th January 2017.)

**Notice of Board Meetings**

The Act as well as Secretarial Standards requires that not less than seven days’ notice in writing shall be given to every director at the registered address as available with the company. The notice can be given by hand delivery or by post or by electronic means.

In case the Board meeting is called at shorter notice, at least one independent director shall be present at the meeting. If he is not present, then decision of the meeting shall be circulated to all directors and it shall be final only after ratification of decision by at least one Independent Director.

**Quorum for Board Meetings: Section 174**

The Act as well as Secretarial Standards provides that one third of total strength or two directors, whichever is higher, shall be the quorum for a meeting. If due to resignations or removal of director(s), the number of directors of the company is reduced below the quorum as fixed by the Articles of Association of the company, then, the continuing Directors may act for the purpose of increasing the number of Directors to that required for the quorum or for summoning a general meeting of the Company. It shall not act for any other purpose.

For the purpose of determining the quorum, the participation by a director through Video Conferencing or other audio visual means shall also be counted. If at any time the number of interested directors exceeds or is equal to two-thirds of the total strength of the Board of directors, the number of directors who are not interested and present at the meeting, being not less than two shall be the quorum during such time.

The meeting shall be adjourned due to want of quorum, unless the articles provide shall be held to the same day at the same time and place in the next week or if the day is National Holiday, the next working day at the same time and place.

**Requirements and Procedures for Convening and Conducting Board’s Meetings**

Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014 provides for the requirements and procedures, in addition to the procedures required for Board meetings in person, for convening and conducting Board meetings through video conferencing or other audio visual means:

1. Every Company shall make necessary arrangements to avoid failure of video or audio visual connection.

2. The Chairperson of the meeting and the company secretary, if any, shall take due and reasonable care:
   a. to safeguard the integrity of the meeting by ensuring sufficient security and identification procedures;
   b. to ensure the availability of proper video conferencing or other audio visual equipment or facilities for providing transmission of the communications for effective participation of the directors and other authorized participants at the Board meeting;
   c. to record the proceedings and prepare the minutes of the meeting;
   d. to store for safekeeping and marking the tape recording(s) or other electronic recording mechanism as part of the records of the company at least before the time of completion of audit.
of that particular year;
(e) to ensure that no person other than the concerned director are attending or have access to the proceedings of the meeting through video conferencing mode or other audio visual means; and
(f) to ensure that participants attending the meeting through audio visual means are able to hear and see the other participants clearly during the course of the meeting, but the differently abled persons, may make request to the Board to allow a person to accompany him.

(3) (a) The notices of the meeting shall be sent to all the directors in accordance with the provisions of sub-section (3) of section 173 of the Act.

(b) The notice of the meeting shall inform the directors regarding the option available to them to participate through video conferencing mode or other audio visual means, and shall provide all the necessary information to enable the directors to participate through video conferencing mode or other audio visual means.

(c) A director intending to participate through video conferencing mode or audio visual means shall communicate his intention to the Chairman or the company secretary of the company.

(d) If the director intends to participate through video conferencing or other audio visual means, he shall give prior intimation to that effect sufficiently in advance so that company is able to make suitable arrangement in this behalf.

(e) Any director who intends to participate in the meeting through the electronic mode may intimate about such participation at the beginning of the calendar year and such declaration shall be valid for one calendar year.

Provided that such declaration shall not debar him from participation in the meeting in person in which case he shall intimate the company sufficiently in advance of his intention to participate in person.

(f) In the absence of any such intimation from the director, it shall be assumed that the director will attend the meeting in person.

(4) At the commencement of the meeting, a roll call shall be taken by the Chairperson when every director participating through video conferencing or other audio visual means shall state, for the record, the following namely :

(a) name;

(b) the location from where he is participating;

(c) that he can completely and clearly see, hear and communicate with the other participants;

(d) that he has received the agenda and all the relevant material for the meeting; and

(e) that no one other than the concerned director is attending or having access to the proceedings of the meeting at the location mentioned in (b) above.

(5) (a) After the roll call, the Chairperson or the Secretary shall inform the Board about the names of persons other than the directors who are present for the said meeting at the request or with the permission of the Chairman and confirm that the required quorum is complete.

Explanation: It is clarified that a director participating in a meeting through video conferencing or other audio visual means shall be counted for the purpose of quorum, unless he is to be
excluded for any items of business under any provisions of the Act or the Rules.

(b) The roll call shall also be made at the conclusion of the meeting and at the re-commencement of the meeting after every break to confirm the presence of a quorum throughout the meeting.

(6) With respect to every meeting conducted through video conferencing or other audio visual means authorised under these rules, the scheduled venue of the meeting as set forth in the notice convening the meeting, shall be deemed to be the place of the said meeting and all recordings of the proceedings at the meeting shall be deemed to be made at such place.

(7) The statutory registers which are required to be placed in the Board meeting as per the provisions of the Act shall be placed at the scheduled venue of the meeting and where such registers are required to be signed by the directors, the same shall be deemed to have been signed by the directors participating through electronic mode if they have given their consent to this effect and it is so recorded in the minutes of the meeting.

(8) (a) Every participant shall identify himself for the record before speaking on any item of business on the agenda.

(b) If a statement of a director in the meeting through video conferencing or other audio visual means is interrupted or garbled, the Chairperson or company secretary shall request for a repeat or reiteration by the director.

(9) If a motion is objected to and there is a need to put it to vote, the Chairperson shall call the roll and note the vote of each director who shall identify himself while casting his vote.

(10) From the commencement of the meeting until the conclusion of such meeting, no person other than the Chairperson, directors, Secretary and any other person whose presence is required by the Board shall be allowed access to the place where any director is attending the meeting either physically or through video conferencing without the permission of the Board.

(11) (a) At the end of discussion on each agenda item, the Chairperson of the meeting shall announce the summary of the decision taken on such item along with names of the directors, if any, dissented from the decision taken by majority and the draft minutes so recorded shall be preserved by the company till the confirmation of the draft minutes in accordance with sub-rule (12).

(b) The minutes shall disclose the particulars of the directors who attended the meeting through video conferencing or other audio visual means.

(12) (a) The draft minutes of the meeting shall be circulated among all the directors within fifteen days of the meeting either in writing or in electronic mode as may be decided by the Board.

(b) Every director who attended the meeting, whether personally or through video conferencing or other audio visual means, shall confirm or give his comments, about the accuracy of recording of the proceedings of that particular meeting in the draft minutes, within seven days or some reasonable time as decided by the Board, after receipt of the draft minutes failing which his approval shall be presumed.

(c) After completion of the meeting, the minutes shall be entered in the minute book as specified under section 118 of the Act and signed by the Chairperson.

Explanation - For the purposes of this rule, ‘video conferencing or other audio visual means’
means audio-visual electronic communication facility employed which enables all the persons participating in a meeting to communicate concurrently with each other without an intermediary and to participate effectively in the meeting.

Matters not to be dealt with in a Meeting through Video Conferencing or other Audio Visual Means

Rule 4 prescribe restriction on following matters which shall not be dealt with in any meeting held through video conferencing or other audio visual means:

(i) the approval of the annual financial statements;
(ii) the approval of the Board’s report;
(iii) the approval of the prospectus;
(iv) the Audit Committee Meetings for consideration of financial statements including consolidated financial statements to be approved by the Board.
(v) the approval of the matter relating to amalgamation, merger, demerger, acquisition and takeover.

Penalty

Every officer of the company who is duty bound to give notice under this section if fails to do so shall be liable to a penalty of twenty five thousand rupees.

Regulation 17(2A) of SEBI (LODR) Regulations, 2015 provide that the quorum for every meeting of the board of directors of the top 1000 listed entities with effect from April 1, 2019 and of the top 2000 listed entities with effect from April 1, 2020 shall be one-third of its total strength or three directors, whichever is higher, including at least one independent director;

The participation of the directors by video conferencing or by other audio-visual means shall also be counted for the purposes of such quorum.

The top 1000 and 2000 entities shall be determined on the basis of market capitalisation, as at the end of the immediate previous financial year.

Compliance with Secretarial Standards relating to Board Meetings

The Companies Act, 2013 has given statutory recognition to the Secretarial Standards issued by the Institute of Company Secretaries of India.

Section 118(10) of the Act reads as under:

Every company shall observe secretarial standards with respect to general and Board meetings specified by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980, and approved as such by the Central Government.

In the context of this provision, observance of Secretarial Standards issued by the Institute of Company Secretaries of India (ICSI) assumes special relevance and companies will have to ensure that there is compliance with these Standards on their part.

Decision Making Process at the Meeting

(I) The Chairman and/or Managing Director should explain the proposal put up before the Board, the
background and the expectation of the proposal in the short as well as the long-term to contribute to the growth of the company. If need be, a presentation may be made by the executive concerned for easing the considerations and discussions of the Board as they tend to highlight the key elements within the written data.

(II) The criticality and viability of the proposal should be explained and their views should be elicited from all angles.

(III) The Board could then deliberate all these issues and come to a decision.

Voting

Voting practices at board meetings differ worldwide. In some countries, it is usual for a majority vote to signify board approval. In this situation, decisions are made quickly and minority dissent is accepted. However, many corporate governance experts argue that boards should be collegial; consensus must be attained on every agenda item without the need to take a vote. In this case, the chairman will often require skill in obtaining unanimity among the directors — even though the debate initially may have involved substantial constructive dissent.

Minutes of the Meeting

Section 118 provides that every company shall prepare, sign and keep minutes of proceedings of every general meeting, including the meeting called by the requisitionists and all proceedings of meeting of any class of shareholders or creditors or Board of Directors or committee of the Board and also resolution passed by postal ballot within thirty days of the conclusion of every such meeting concerned. In case of meeting of Board of Directors or of a committee of Board, the minutes shall contain name of the directors present and also name of dissenting director or a director who has not concurred the resolution. The chairman shall exercise his absolute discretion in respect of inclusion or non-inclusion of the matters which is regarded as defamatory of any person, irrelevant or detrimental to company's interest in the minutes.

Minutes kept shall be evidence of the proceedings recorded in a meeting.

Rule 25 of the Companies (Management and Administration) Rules, 2014 contains provisions with regards to minutes of meetings.

A distinct minute book shall be maintained for each type of meeting namely:

(i) general meetings of the members;

(ii) meetings of the creditors;

(iii) meetings of the Board; and

(iv) meetings of the committees of the Board.

It may be noted that resolutions passed by postal ballot shall be recorded in the minute book of general meetings as if it has been deemed to be passed in the general meeting. In no case the minutes of proceedings of a meeting or a resolution passed by postal ballot shall be pasted to any such book.

In case of every resolution passed by postal ballot, a brief report on the postal ballot conducted including the resolution proposed, the result of the voting thereon and the summary of the scrutinizer's report shall be entered in the minutes book of general meetings along with the date of such entry within thirty days from the date of passing of resolution.
Minutes of proceedings of each meeting shall be entered in the books maintained for that purpose along with the date of such entry within thirty days of the conclusion of the meeting. Each page of every such book shall be initialed or signed and the last page of the record of proceedings of each meeting or each report in such books shall be dated and signed by:

- in the case of minutes of proceedings of a meeting of the Board or of a committee thereof, by the chairman of the said meeting or the chairman of the next succeeding meeting;
- in the case of minutes of proceedings of a general meeting, by the chairman of the same meeting within the aforesaid period of thirty days or in the event of the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose;
- in case of every resolution passed by postal ballot, by the chairman of the Board within the aforesaid period of thirty days or in the event of there being no chairman of the Board or the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose.

Minutes books shall be preserved permanently and kept in the custody of the company secretary of the company or any director duly authorized by the Board for the purpose. The minutes books of board and committee meetings shall be kept in the registered office or such place as the board may decide. The minutes books of general meeting shall be kept at the registered office of the company.

**Adequacy of Minutes**

Minutes are the written record of a board or committee meeting. Preparation of minutes of general, Board and committee meetings is a legal requirement under section 118 of Companies Act, 2013. The Company secretary should ensure compliance of the same accordingly. At a minimum, the minutes must contain:

- Meeting location and date
- Names of attendees and absentees
- Principal points arising during discussion
- Board decisions

Minutes record what actually happens at a meeting in the order in which it happened, regardless of whether the meeting followed the written agenda. The minutes are important legal documents and, by law, must be kept by the company. They also serve as important reminders of action to be taken between meetings.

Minutes should strike a balance between being a bare record of decisions and a full account of discussions. On more routine housekeeping matters or more sensitive personnel issues, a brief record is appropriate. For most items, there should be a summary of the matter discussed and the issues considered. The final decision must be recorded clearly and concisely. That amount of attention is desirable to show that the board has acted with due care and complied with any legal duties and obligations.

Where a director disagrees with a board decision, he may ask to have their disagreement recorded in the minutes. This could be important to avoid future liability for any decision that involves a breach of law or misuse of the board’s powers.

It is the chairman’s responsibility to ensure that sufficient time is allowed for discussion of complex or contentious issues. It is a good practice to draft the minutes of the meetings and circulate them to the directors in reasonable time, perhaps not later than a week.
Confidentiality

All board papers and proceedings should be considered to be highly confidential. Board papers should not be shown or circulated to non-directors. Directors should take great care not to discuss or disclose any board meeting content or proceedings outside the boardroom.

As per SS-1

Minutes shall be recorded in books maintained for that purpose.

A distinct Minutes Book shall be maintained for Meetings of the Board and each of its Committees.

A company may maintain its Minutes in physical or in electronic form. Minutes may be maintained in electronic form in such manner as prescribed under the Act and as may be decided by the Board. Minutes in electronic form shall be maintained with Timestamp.

The pages of the Minutes Books shall be consecutively numbered.

Minutes shall not be pasted or attached to the Minutes Book, or tampered with in any manner.

Minutes Books, if maintained in loose-leaf form, shall be bound periodically depending on the size and volume and coinciding with one or more financial years of the company.

Minutes Books shall be kept at the Registered Office of the company or at such other place as may be approved by the Board.

- Minutes shall contain a fair and correct summary of the proceedings of the Meeting.
- Minutes shall be written in clear, concise and plain language.
- Wherever the decision of the Board is based on any unsigned documents including reports or notes or presentations tabled or presented at the Meeting, which were not part of the notes on agenda and are referred to in the Minutes, shall be identified by initialling of such documents by the Company Secretary or the Chairman.
- Where any earlier Resolution(s) or decision is superseded or modified, Minutes shall contain a specific reference to such earlier Resolution(s) or decision or state that the Resolution is in supersession of all earlier Resolutions passed in that regard.
- Minutes of the preceding Meeting shall be noted at a Meeting of the Board held immediately following the date of entry of such Minutes in the Minutes Book.
- Within fifteen days from the date of the conclusion of the Meeting of the Board or the Committee, the draft Minutes thereof shall be circulated by hand or by speed post or by registered post or by courier or by e-mail or by any other recognised electronic means to all the members of the Board or the Committee, as on the date of the meeting, for their comments.
- Minutes shall be entered in the Minutes Book within thirty days from the date of conclusion of the Meeting.
- The date of entry of the Minutes in the Minutes Book shall be recorded by the Company Secretary.
- Minutes, once entered in the Minutes Book, shall not be altered. Any alteration in the Minutes as entered shall be made only by way of express approval of the Board at its subsequent Meeting at which the minutes are noted by the Board and the fact of such alteration shall be recorded in the Minutes of such subsequent meeting.
Minutes of the Meeting of the Board shall be signed and dated by the Chairman of the Meeting or by the Chairman of the next Meeting.

The Chairman shall initial each page of the Minutes, sign the last page and append to such signature the date on which and the place where he has signed the Minutes.

Minutes, once signed by the Chairman, shall not be altered, save as mentioned in this Standard.

Within fifteen days of signing of the Minutes, a copy of the said signed Minutes, certified by the Company Secretary or where there is no Company Secretary by any Director authorised by the Board, shall be circulated to all the Directors, as on the date of the Meeting and appointed thereafter, except to those Directors who have waived their right to receive the same either in writing or such waiver is recorded in the Minutes.

The Minutes of Meetings of the Board and any Committee thereof can be inspected by the Directors.

Extracts of the Minutes shall be given only after the Minutes have been duly entered in the Minutes Book. However, certified copies of any Resolution passed at a Meeting may be issued even earlier, if the text of that Resolution had been placed at the Meeting.

Minutes of all Meetings shall be preserved permanently in physical or in electronic form with Timestamp.

Office copies of Notices, Agenda, Notes on Agenda and other related papers shall be preserved in good order in physical or in electronic form for as long as they remain current or for eight financial years, whichever is later and may be destroyed thereafter with the approval of the Board.

Minutes Books shall be in the custody of the Company Secretary.

**Separate Meetings**

Boards shall consider organizing separate meetings with independent directors to update them on all business-related issues and new initiatives. These meetings give an opportunity for independent directors for exchanging valuable views on the issues to be raised at the Board meetings. Such meetings are chaired by the senior/lead independent director. The outcome of the meeting is put forward at the Board meeting.

Schedule IV of the Companies Act, 2013 provides the following regarding a separate meeting of the Independent Directors:

1. The independent directors of the company shall hold at least one meeting in a financial year, without the attendance of non-independent directors and members of management;

2. All the independent directors of the company shall strive to be present at such meeting;

3. 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.
Further, SEBI (LODR) Regulations also mandates the separate meeting of independent directors for all the listed companies. The provisions given in the companies Act and that in the SEBI (LODR) Regulations regarding separate meeting are same.

**Directors’ Time Commitment**

Directors typically should allocate at least as much time for preparation as for the board meeting itself. With strategy retreats or “away days,” travel, reading, meeting preparation time, and attendance at ad hoc and committee meetings, directors usually spend three or four days per month for a single, non-executive director position.

The time spent to prepare for audit committee meetings is normally longer than that for most other board meetings.

Should the time commitment of directors become an issue, then companies may wish to limit the number of external appointments that directors can hold.

Directors should always evaluate the demands on their time before allowing themselves to be considered for an appointment. Directors should disclose any other board or external appointment to the nomination committee before their appointment, and regularly update the board after appointment.

**Powers of the Board**

In terms Section 179 of the Companies Act, 2013 the Board of directors of a company shall be entitled to exercise all such powers, and to do all such acts and things, as the company is authorised to exercise and do. The Board shall not exercise any power or do any act or thing which is required, whether by this or any other Act or by the memorandum or articles of the company, to be exercised or done by the company in general meeting.

As per Section 179(3) read with Rule 8 of Companies (Meetings of Board and its Powers) Rules, 2014, the Board of Directors of a company shall exercise the following powers on behalf of the company by means of resolutions passed at meetings of the Board, namely:—

1. to make calls on shareholders in respect of money unpaid on their shares;
2. to authorise buy-back of securities under section 68;
3. to issue securities, including debentures, whether in or outside India;
4. to borrow monies;
5. to invest the funds of the company;
6. to grant loans or give guarantee or provide security in respect of loans;
7. to approve financial statement and the Board’s report;
8. to diversify the business of the company;
9. to approve amalgamation, merger or reconstruction;
10. to take over a company or acquire a controlling or substantial stake in another company;
11. to make political contributions;
12. to appoint or remove key managerial personnel (KMP);
(13) to appoint internal auditors and secretarial auditor.

The Board may, by a resolution passed at a meeting, delegate to any committee of directors, the managing director, the manager or any other principal officer of the company or in the case of a branch office of the company, the principal officer of the branch office, the powers specified in (4) to (6) above on such conditions as it may specify.

The banking company is not covered under the purview of this section. Also that in case of a Specified IFSC public company, the Board can exercise powers by means of resolutions passed at the meetings of the Board or through resolutions passed by circulation. The company may impose restriction and conditions on the powers of the Board.

Section 180 imposes restrictions on the powers of the Board. It provides that the board can exercise the following powers only with the consent of the company by special resolution:–

(a) to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings;

(b) to invest otherwise in trust securities the amount of compensation received by it as a result of any merger or amalgamation;

(c) to borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital and free reserves and securities premium, apart from temporary loans obtained from the company’s bankers in the ordinary course of business;

(d) to remit, or give time for the repayment of, any debt due from a director.

The special resolution relating to borrowing money exceeding paid up capital and free reserves specify the total amount up to which the money may be borrowed by Board. The title of buyer or the person who takes on lease any property, investment or undertaking on good faith cannot be affected and also in case if such sale or lease covered in the ordinary business of such company. The special resolution may also stipulate the conditions, including conditions regarding the use, disposal, investment of the sale proceeds, which may result from such transactions but this doesn’t authorise the company to reduce its capital except the provisions contained in this Act.

The debt incurred by the company exceeding the paid up capital and free reserves is not valid and effectual, unless the lender proves that the loan was advanced on good faith and without knowledge that the limit imposed had been exceeded.

**SEGMENT III**

**RESPONSIBILITIES OF BOARD**

Responsibilities cast upon Directors are quite onerous and multifarious. The duties of directors are partly statutory, partly regulatory and partly fiduciary. Directors are in a fiduciary position and must exercise their powers for the benefit of the company. Board is responsible for direction, control, conduct management and supervision of the company’s affairs. They have to establish effective corporate governance procedures and best practices and whistle blower mechanism. Ultimate control and management of the company vests with the Board. The board functions on the principle of majority or unanimity. A decision is taken on record if it is accepted by the majority or all of the directors. A single director cannot take a decision. This is one of the purposes of forming a board. If the power of decision making is given to a single director he might take
biased decisions. He may take decisions which benefit him in his personal capacity. The scope of bias, partiality and favouritisms is eliminated with the concept of the board.

The purpose of having a board in a company is:

- To contribute to the business of the company through their knowledge and skills.
- To advise on such matters as need their attention and influence.
- To critically analyze the performance and operations of the company.
- To be able to act as a professional aide.
- To be able to offer their professional expertise in the relevant field.
- To establish sound business principles and ethics.
- To act as a mentor to the management.

The responsibilities of the directors can be summarized as below:

**Responsibilities towards the company**

The board should ensure that:

- It acts in the best interest of the company.
- The decisions it takes do not serve the personal interests of its members.
- It helps the company in increasing its profits and turnover by following principles of equity, ethics and values.
- It helps the company in building its goodwill.
- It shares with the management the decision taken by them and the reasons thereof.
- That the company has systems and means to best utilize the resources of the company and especially its intangible resources.

**Responsibilities towards management**

The board must ensure that:

- It gives its guidance, support and direction to the management in every decision.
- It acts as leader to inspire and motivate the management to perform their duties.
- It encourages compliance and disclosures.
- It trusts the management and gives it the freedom to act.
- It does not dictate terms but take objective decisions.
- It follows the company’s code of conduct and the other rules and the regulations of the company.

**Responsibilities towards stakeholders**

The board must ensure that:

- Its every decision helps in the increasing the stakeholders value.
It does not act in a manner by which any stakeholder is prejudiced.

- One stakeholder should not be benefited at the cost of the other. — It must discourage restrictive or monopolistic activities for the undue benefit of the company.

- That proper system is established and followed which helps in resolving the grievances of the stakeholders.

- The company has policies for different class of stakeholders which are equally applicable. Such policies should be based on the principles of equity and justice.

- The company discloses its policies to all the stakeholders.

- The stakeholders are able to establish long term relationships based on trust and confidence.

**Corporate Social Responsibility**

The board must ensure that:

- The company has policies which encourage social activities on purely non profitable basis.

- Such policies are followed ethically and resources are provided to give effect to these policies.

- The actual benefit is actually passed on to the society by doing such activities.

- That these policies cover activities such as upliftment of society, providing education to the needy, promoting employment, preservation of environment, etc.

- That the company's products are eco-friendly and comply with all the related norms.

- That the company does not take any decision which affects the society adversely.

**Responsibility towards government**

The board must ensure that:

- The company complies with all the laws applicable to it whether they are the central laws or state laws.

- There are systems and checks to ensure that the above is complied.

- That all the dues towards the government in the form of taxes, rates, etc. are paid on time.

- It supports the initiatives taken by the government for the promotion of welfare and security of the nation.

**Inter-se responsibilities**

The board must ensure that:

- True and full disclosure of all the transactions, where there is an interest, is made to the other members of the board.

- It follows board decorum and code for conduct of meetings.

- All relevant information is shared among themselves for a proper decision making.

- It is able to take independent, unbiased and objective decisions.

- The executive directors respect and give due regard to the presence and opinions of the non-executive independent directors.
The effectiveness of the board depends largely on the leadership skills, capabilities and commitment to corporate governance practices of each individual director. The responsibility of the board is also to provide leadership in advancing the company’s vision, values and guiding principles. The board is collectively responsible for promoting the success of the company by directing and supervising the company’s affairs. The board’s role is to provide entrepreneurial leadership within a framework of prudent and effective controls, which enable risk to be assessed and managed. The board sets the company’s strategic aims, ensures that the necessary financial, human resources & infrastructure are in place for the Company to meet its objectives and review management performance.

Policy Governance

Policy Governance, an integrated board leadership paradigm created by Dr. John Carver, is a groundbreaking model of governance designed to empower boards of directors to fulfill their obligation of accountability for the organizations they govern. As a generic system, it is applicable to the governing body of any enterprise. The model enables the board to focus on the larger issues, to delegate with clarity, to control management’s job without meddling, to rigorously evaluate the accomplishment of the organization; to truly lead its organization.

Policy Governance framework is designed to enable intelligent, well-intended board members to govern as well as to perform as far as possible. It “channels the wisdom of board members, links them and their work to important constituencies, focuses them on the large long term issues, and makes possible the optimal empowerment and fair judgment of management”.

The popular belief is that board is not a mere overseer of management actions; nor is it an approver. It is a locus of decision making in the owner-to-operator sequence of authority. Contrary to being an approver, it is a generator, an active link in the chain of command.

“Boards should make policy, boards should deal with vision and the long term, boards should avoid trivia, boards should not meddle and micromanage; all board members should come prepared and be participative, and so forth. These exhortations may be good ones, but they are elementary in the extreme-more fitting for Polonius than for a theorist. At any rate, it is embarrassing that they are the level addressed by many of the efforts to improve modern governance. Policy governance goes much, much further.”

Policy Governance defines policy to include all possible pronouncements within a carefully crafted arrangement encompassing all board policies.

“...It is the single, central repository of written board wisdom, rather than one of several board products. Replacing reams of previous board documents, these documents often number fewer than fifty pages—board members can actually master all of them, using them as working documents and making frequent amendments. Moreover, board policies are truly the board’s policies, having been generated from board deliberation, not parroted from management recommendations. Explicit, comprehensive governing values of the organization enable new board members to find quickly what the board stands for. The chairperson and CEO have an unambiguous source for knowing board expectations of their roles”.

Policy Governance separates issues of organizational purpose (ENDS) from all other organizational issues
(MEANS), placing primary importance on those Ends. Policy Governance boards demand accomplishment of purpose, and only limit the staff's available means to those which do not violate the board's pre-stated standards of prudence and ethics.

The board's own Means are defined in accordance with the roles of the board, its members, the chair and other officers, and any committees the board may need to help it accomplish its job. This includes the necessity to "speak with one voice". Dissent is expressed during the discussion preceding a vote. Once taken, the board's decisions may subsequently be changed, but are never to be undermined. The board's expectations for itself also set out self-imposed rules regarding the delegation of authority to the staff and the method by which board-stated criteria will be used for evaluation. Policy Governance boards delegate with care. There is no confusion about who is responsible to the board or for what board expectations they are responsible. Furthermore, boards that decide to utilize a CEO function are able to hold this one position exclusively accountable.

RELATIONSHIP BETWEEN DIRECTORS AND EXECUTIVE

Board and executive leadership need to work together based on mutual respect, trust and commitment. A board provides counsel to management and should not get involved in the day-to-day affairs of the organization. Clear expectations for the board and the director need to be established and maintained, because a board that is overly active in management can inhibit the organization's effectiveness. The Executive Management can help the board govern more and manage less by adopting the following three methods:

→ Use a comprehensive strategic plan that has been developed in conjunction with the board, and supplement it with regular progress reports. This will keep the board's sights focused on the long term goals and mission of the organization. Regular reports will keep board members apprised of progress toward organizational goals, and provide part of the basis for evaluation of the executive management.

→ Provide the board with relevant materials before board meetings, and explain why the materials are coming to the attention of the board. Let board members know how specific agenda items relate to the organization's larger mission, and what kind of action or discussion is desired of the board on each item.

→ Facilitate board and board committee discussions so that the board stays focused on the larger issues. Refer to set policies that define the limits of the board's decision-making power, and strive to engage the board in a dialogue among themselves that leads to consensus-building.

THE KEY DIFFERENCE BETWEEN DIRECTORS AND MANAGERS

There are many fundamental differences between being a director and a manager. The differences are numerous, substantial and quite onerous. The table below gives a detailed breakdown of the major differences between directing and managing:

<table>
<thead>
<tr>
<th>Basis</th>
<th>Directors</th>
<th>Managers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leadership</td>
<td>It is the board of directors who must provide the intrinsic leadership and direction at the top of the organization.</td>
<td>It is the role of managers to carry through the strategy on behalf of the directors.</td>
</tr>
<tr>
<td>Decision Making</td>
<td>Directors are required to determine the future of the organization and protect its assets and reputation. They also need to consider how their decisions related to ‘Stake-holders’ and the regulatory framework.</td>
<td>Managers are concerned with implementing the decisions and the policies made by the board.</td>
</tr>
<tr>
<td>Duties and responsibilities</td>
<td>Directors, not managers, have the ultimate responsibility for the long-term prosperity of the company. Directors are required in law to apply skill and care in exercising their duty to the company and are subject to fiduciary duties. If they are in breach of their duties or act improperly directors may be made personally liable in both civil and criminal law. On occasions, directors can be held responsible for acts of the company. Directors also owe certain duties to the stakeholders of the company.</td>
<td>Managers have far fewer legal responsibilities.</td>
</tr>
<tr>
<td>Relationship with shareholders</td>
<td>Directors are accountable to the shareholders for the company's performance and can be removed from office by them or the shareholders can pass a special resolution requiring the Directors to act in a particular way. Directors act as “Fiduciaries” of the shareholders and should act in their best interests by also taking into account the best interests of the company (as a separate legal entity) and the other stakeholders.</td>
<td>Managers are usually appointed and dismissed by directors or management and do not have any legal requirement to be held to account.</td>
</tr>
<tr>
<td>Ethics and values</td>
<td>Directors have a key role in the determination of the values and ethical position of the company.</td>
<td>Managers must enact the ethos, taking their direction from the board.</td>
</tr>
<tr>
<td>Company Administration</td>
<td>Directors are responsible for the company’s administration.</td>
<td>While the related duties associated with company administration can be delegated to managers, the ultimate responsibility for them resides with the directors.</td>
</tr>
<tr>
<td>Statutory Provisions on insolvency</td>
<td>If a company becomes insolvent, law imposes various duties and responsibilities on directors that may involve personal liability, criminal prosecution and disqualification.</td>
<td>These statutory provisions do not affect managers.</td>
</tr>
<tr>
<td>Statutory Provisions in</td>
<td>There are many other statutory provisions that can create offences on strict liability under</td>
<td>Generally managers are not responsible under the Statutory</td>
</tr>
</tbody>
</table>
Barriers to Visionary Leadership

Frank Martinelli - Lists the barriers with a view to helping companies identify them in their organizations and to remove them to facilitate visionary board leadership:

► **Lack of Time Management** - Lack of time to attend meetings, read materials and maintain contact with each other in between meetings. The board members need to organize themselves for maximum effectiveness and avoid wasting time on trivial matters.

► **Resistance to risk taking** - In order to be innovative and creative in its decision-making, boards must be willing to take chances, to try new things, to take risks. Success in new ventures is never to be taken for granted. Boards need to acknowledge the tension points and discuss them with funders and other key supporters. Board leadership must strike a balance between taking chances and maintaining the traditional stewardship role.

► **Lack of Strategic Planning** - Strategic planning offers boards an opportunity to think about changes and trends that will have significant impact and develop strategies to respond to challenges. Some boards are not involved in strategic planning at all; others are involved in a superficial way. Therefore, the boards lose an important opportunity to hone/exercise visionary leadership skills.

► **Complexity** - Board members frequently lack a deep understanding of critical changes, trends and developments that challenge fundamental assumptions about how it defines its work and what success looks like. This lack of knowledge results in a lack of confidence on the part of the board to act decisively and authoritatively.

► **Micro Management** - It is necessary that the board focuses its attention on items of critical importance to the organization. If the board is tempted to micro manage or to meddle in lesser matters, an opportunity to provide visionary leadership is lost.

► **Clinging to Tradition** – Boards often resist change in order to preserve tradition. However, changing environment requires the Boards to be open to change. Maira and Scott - Morgan in “The Accelerating Organisation” point out that continuous shedding of operating rules is necessary because of changing environmental conditions. But shedding becomes more complicated in systems involving human beings, because their sense of self-worth is attached to many old rules. This human tendency to hold on to the known prevents boards from considering and pursuing new opportunities which conflict with the old rules.

► **Confused Roles** - Some boards assume that it is the job of the executive director to do the
visionary thinking and that the board will sit and wait for direction and inspiration. This lack of clarity can result in boards that do not exercise visionary leadership because they do not think it is their job.

- Past Habit - Time was when clients, members and consumers would just walk in through the door on their own. Viewing things in this way, boards did not consider marketplace pressures, or for that matter a competitive marketplace. All that has changed, yet for many boards their leadership style has not kept pace with this new awareness.

SEGMENT IV

TRAINING OF DIRECTORS

Need, objective and methodology

An important aspect of Board effectiveness would be appropriate attention to development and training of directors on the lines of management development and training. Director induction should be seen as the first step of the board’s continuing improvement. Investing in board development strengthens the board and individual directors. The normal expectation is that independent directors having been invited to join the Board due to their rich background and expertise, may not need any training. As the Board of Directors is primarily responsible for good governance practices, which is quite different from management, it calls for new areas of knowledge and different skills. Training should encompass both a thorough induction programme and an ongoing training and development opportunities for the board members. Since the Board composition is getting more diverse a system of formal training and evaluation is very important to foster trust, cohesion and communication among board members.

Director Induction

Induction procedures should be in place to allow new directors to participate fully and actively in board decision-making at the earliest opportunity. To be effective, new directors need to have a good deal of knowledge about the company and the industry within which it operates. It involves introducing the new directors to the people with whom they will be working and explaining how the board operates. It involves building up rapport, trust, and credibility with the other directors so that the new director is accepted by and can work with fellow directors.

Common methods of induction include:

- Briefing papers
- Internal visits
- Introductions

An induction programme should be available to enable new directors to gain an understanding of:

- the company’s financial, strategic, operational and risk management position
- the rights, duties and responsibilities of the directors
- the roles and responsibilities of senior executives
- the role of board committees.

An induction kit should be given to new directors which should contain the following:
- Memorandum and Articles of Association with a summary of most important provisions
- Brief history of the company
- Current business plan, market analysis and budgets
- All relevant policies and procedures, such as a policy for obtaining independent professional advice for directors;
- Protocol, procedures and dress code for Board meetings, general meetings, staff social events, site visits etc including the involvement of partners;
- Press releases in the last one year
- copies of recent press cuttings and articles concerning the company
- Annual report for last three years
- Notes on agenda and Minutes of last six Board meetings
- Board’s meeting schedule and Board committee meeting schedule
- Description of Board procedures.

**Directors Development Programme**

Professional development should not be treated as merely another training schedule rather it must be more structured so as to sharpen the existing skills and knowledge of directors. It is a good practice for boards to arrange for an ongoing updation of their members with changes in governance, technologies, markets, products, and so on through:

- Ongoing education
- Site visits
- Seminars; and
- Various short term and long term Courses

**Training of Independent Directors – Regulation 25 of SEBI (LODR) Regulations**

a. The company shall provide suitable training to independent directors to familiarize them with the company, their roles, rights, responsibilities in the company, nature of the industry in which the company operates, business model of the company, etc.

b. The details of such training imparted shall be disclosed in the Annual Report.

**PERFORMANCE EVALUATION OF BOARD & INDIVIDUAL DIRECTOR**

A formal evaluation of the board and the individual directors is one potentially effective way to respond to the demand for greater board accountability and effectiveness. Feedback about the performance of individual board members can help them enhance their skill as directors and can motivate them to be better board members. Evaluations can provide an ongoing means for directors to assess their performance. Board appraisals, if conducted properly produce a number of positive outcomes. In addition to the obvious benefit
of greater board accountability, four areas of performance improvement have been identified:

1. more effective board operations,
2. better team dynamics and communication,
3. greater clarity with regard to member roles and responsibilities, and
4. improved CEO-board relations.

Soliciting feedback and reflecting on the board’s performance through a formal process encourages boards to pay greater attention to how they actually operate and in turn are very helpful in identifying ways to improve the board. As a result of such a process, suggestions and concerns about boardroom activities emerge more often and more constructively from board members.

Evaluations of group performance usually encourage a more thorough examination of an individual’s and a group’s responsibilities and roles. Board evaluations are no exception. By focusing on the board as a team and on its overall performance, communication and overall level of participation also improves.

The performance appraisal of executive directors is judged by the performance/the operating results of the company. The performance appraisal of non-executive directors is complex. Normally companies use—

**Self-appraisal**

peer review method wherein the every director’s performance is reviewed by the other directors.

This is done under the direction of a lead independent director/chairman.

Proviso 2 to Section 178 of the Companies Act, 2013 provides that the Nomination and Remuneration Committee shall carry out evaluation of every director’s performance. Further, Schedule IV of the Companies Act, 2013 provides for the following evaluation mechanism of independent directors:

1. 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.

Section 134(2) (p) provides that 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 report by Board of Directors

SEBI (LODR) Regulations provide following for the performance evaluation of independent directors:

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

b. The listed entities 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.

**Major Factors for Evaluation:**

- The quality of the issues that get raised, discussed and debated at the meetings of the Board and its Committees.
- The guidance provided by the Board in the light of changing market conditions and their impact on the organisation.
- The methodology adopted by the Board to solve issues referred to them such as, the homework done by the Board on the problem presented to them, the information they seek to get a complete picture of the situation, the points of view presented to solve the issue, the harmonization of remedial measures proposed by the Board and ensuring the implementation of the solution by the management with appropriate and timely review mechanism.
- The effectiveness of the directions provided by the Board on the issues discussed in meetings.

**Parameters**

→ Performance of the Board against the performance benchmarks set.
→ Overall value addition by the discussions taking place at the Board meetings.
→ The regularity and quality of participation in the deliberations of the Board and its Committees.
→ The answerability of the top management to the Board on performance related matters.

**Model questions suggested in “Review of the role and effectiveness of non-executive directors” by Derek Higgs, January 2003 (Higgs Report) -**

**Performance evaluation of the board**

How well has the board performed against any performance objectives that have been set?

What has been the board’s contribution to the testing and development of strategy?

What has been the board’s contribution to ensuring robust and effective risk management?

Is the composition of the board and its committees appropriate, with the right mix of knowledge and skills to maximize performance in the light of future strategy? Are inside and outside the board relationships working effectively?

How has the board responded to any problems or crises that have emerged and could or should these have been foreseen?

Are the matters specifically reserved for the board the right ones?

How well does the board communicate with the management team, company employees and others? How effectively does it use mechanisms such as the AGM and the annual report? Is the board as a whole up to date with latest developments in the regulatory environment and the market?

How effective are the board’s committees? (Specific questions on the performance of each committee should be included such as, for example, their role, their composition and their interaction with the board.)

The processes that help underpin the board’s effectiveness should also be evaluated. For eg.:

- Is appropriate, timely information of the right length and quality provided to the board and is
management responsive to requests for clarification or amplification? Does the board provide helpful feedback to management on its requirements?

- Are sufficient board and committee meetings of appropriate length held to enable proper consideration of issues? Is time used effectively?
- Are board procedures conducive to effective performance and flexible enough to deal with all eventualities?

In addition, there are some specific issues relating to the chairman which should be included as part of an evaluation of the board's performance, e.g.:

- Is the chairman demonstrating effective leadership of the board?
- Are relationships and communications with shareholders well managed?
- Are relationships and communications within the board constructive?
- Are the processes for setting the agenda working? Do they enable board members to raise issues and concerns?
- Is the company secretary being used appropriately and to maximum value?

**Performance Evaluation of the Non-Executive Director**

The chairman and other board members should consider the following issues and the individual concerned should also be asked to assess themselves. For each non-executive director:

- How well prepared and informed are they for board meetings and is their meeting attendance satisfactory?
- Do they demonstrate a willingness to devote time and effort to understand the company and its business and a readiness to participate in events outside the boardroom, such as site visits?
- What has been the quality and value of their contributions at board meetings?
- What has been their contribution to development of strategy and to risk management?
- How successfully have they brought their knowledge and experience to bear in the consideration of strategy?
- How effectively have they probed to test information and assumptions? Where necessary, how resolute are they in maintaining their own views and resisting pressure from others?
- How effectively and proactively have they followed up their areas of concern?
- How effective and successful are their relationships with fellow board members, the company secretary and senior management?
- Does their performance and behavior engender mutual trust and respect within the board?
- How actively and successfully do they refresh their knowledge and skills and are they up to date with:
  - the latest developments in areas such as corporate governance framework and financial reporting?
  - the industry and market conditions?
- How well do they communicate with fellow board members, senior management and others, for example shareholders. Are they able to present their views convincingly yet diplomatically and do they listen and
take on board the views of others?

The list excludes any specific questions about the performance of each non executive director on board committee, although some of the questions in this list could be made applicable to their committee in which they serve. (It may also be mentioned here that the Higgs suggestions do not include any list of questions for the evaluation performance of executive directors)

The list given above is not an exhaustive one or definitive and the corporate may design their own questions depending upon the approach of the company and having regard to the particular circumstances.

CONCLUSION

In today’s era where uncertainty has crept in to such an extent, that running a business is not as simple as it was when the demand for the commodity was easily identifiable, consumer was not much educated, competitors were not playing, social responsibilities was not weighed and technology not ever changing.

Today, it has become imperative to have a board which through its strong ethics, values, independence, wisdom, acumen, perception and insight is able to direct the company towards the road to success. The board functions on the principle of majority or unanimity. A decision is taken on record if it is accepted by the majority or all of the directors. A single director cannot take a decision. However, every director should provide a creative contribution to the Board by providing objective criticism.

GLOSSARY OF TECHNICAL WORDS

- **Globalization**: Globalization implies the opening of local and nationalistic perspectives to a broader outlook of an interconnected and interdependent world with free transfer of capital, goods, and services across national frontiers. However, it does not include unhindered movement of labor and, as suggested by some economists, may hurt smaller or fragile economies if applied indiscriminately.

- **Accountability**: The obligation of an individual or organization to account for its activities, accept responsibility for them, and to disclose the results in a transparent manner. It also includes the responsibility for money or other entrusted property.

- **Corporate Citizen**: The legal status of a corporation in the jurisdiction in which it was incorporated.

- **Holding Company**: “Holding Company”, in relation to one or more other companies, means a company of which such companies are subsidiary companies.

- **Minutes**: Minutes, also known as minutes of meeting, protocols or, informally, notes, are the instant written record of a meeting or hearing.

- **Familiarization Programmes**: The Familiarization Programmes are aimed to familiarize the independent directors with the company, their roles responsibilities in the company, nature of industry in which the company operates and business model of the company by imparting suitable training sessions.

LESSON ROUND UP

- The Board of Directors plays a pivotal role in ensuring good governance. The contribution of directors on the Board is critical to the way a corporate conducts itself.

- Responsibilities of Board - to establish an organizational vision and mission, giving strategic direction and advice, overseeing strategy implementation and performance, developing and evaluating the CEO, to ensure the organization has sufficient and appropriate human resources, ensuring effective stakeholder relations, risk mitigation, procuring resources.
The board functions on the principle of majority or unanimity. A decision is taken on record if it is accepted by the majority or all of the directors. A single director cannot take a decision.

Executive director or ED is a common post in many organisations, but the Companies Act does not define the phrase.

Non-executive directors do not get involved in the day-to-day running of the business.

Independent directors are known to bring an objective view in board deliberations. They also ensure that there is no dominance of one individual or special interest group or the stifling of healthy debate. They act as the guardians of the interest of all shareholders and stakeholders, especially in the areas of potential conflict.

Board composition is one of the most important determinants of board effectiveness. A board should have a mix of inside/Independent Directors with a variety of experience and core competence if it is to be effective in setting policies and strategies and for judging the management’s performance objectively.

The effectiveness of the board depends largely on the leadership skills, capabilities and commitment to corporate governance practices of each individual director.

The Chairman’s primary responsibility is for leading the Board and ensuring its effectiveness.

A board provides counsel to management and should not get involved in the day-to-day affairs of the organization. Clear expectations for the board and the director need to be established and maintained, because a board that is overly active in management can inhibit the organization’s effectiveness.

Board and executive leadership need to work together based on mutual respect trust and commitment.

Induction and continuous training of Directors is of utmost importance to keep them updated with latest happenings in the company and major developments that impact the company.

A formal evaluation of the board and of the individual directors is one potentially effective way to respond to the demand for greater board accountability and effectiveness.

An effective board evaluation requires the right combination of timing, content, process, and individuals.

ICSI Recommendations to Strengthen Corporate Governance Framework – Post Satyam, the Council of the Institute of Company Secretaries of India constituted a Core Group to analyse the issues arising out of Satyam Episode and to inter alia make suitable recommendations for policy and regulatory changes in the legal framework. The Core Group undertook a detailed study of the prevailing corporate governance practices across the world, the recommendations of various committees and corporate governance codes, the best practices adopted by the industry and after benchmarking the best practices that can be mandated, made its recommendations ‘ICSI recommendations to Strengthen Corporate Governance Framework’ which were approved by the Council of the Institute.

SELF TEST QUESTIONS
(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. As a Company secretary of a company you are required to prepare a note to the Board explaining the importance of Board meetings in a good governance structure.

2. Should the role of Chairman and CEO be separated?

3. ABC Ltd. is a FMCG company. You as a company Secretary are required to prepare a draft of valid questions for the purpose of Board evaluation.
4. Write Short Notes on –
   (a) Board Composition
   (b) Training of Directors
   (c) Board Charter
   (d) Lead Independent Director
   (e) Board Evaluation
Lesson 5
Board Committees

LESSON OUTLINE
- Introduction
- Need for Committees
- Audit Committee
- Nomination and Remuneration Committee
- Stakeholders Relationship Committee
- CSR Committee
- Other Committees
  - Risk management Committee
  - Corporate Governance Committee
  - Regulatory, Compliance and Government Affairs Committee
  - Science Technology and Sustainability Committee
- Glossary
- Lesson Round-Up
- Self Test Questions

LEARNING OBJECTIVES
The objective of this study lesson is to enable the students to understand the need and advantages of management through board committees and the constitution and scope of various Committees. In this study lesson, students would be able to understand effective company management through the delegation of power and responsibilities to various board committees.

This chapter briefs about the Committees to be constituted mandatorily - Audit Committee, Nomination and Remuneration Committee, Stakeholders Relationship Committee and CSR Committee and non mandatory committees like Corporate Governance Committee, Science Technology and Sustainability Committee, Risk Management Committee, Regulatory, Compliance and Government Affairs Committee.

This chapter provides knowledge about various committees of the Board. This chapter may be useful in performing the advisory role and in compliance management in practical areas of work.

"Committees have become so important nowadays that subcommittees have to be appointed to do the work"

-Laurence J. Peter
INTRODUCTION

A board committee is a small working group identified by the board, consisting of board members, for the purpose of supporting the board’s work. Committees are generally formed to perform some expertise work. Members of the committee are expected to have expertise in the specified field.

Committees are usually formed as a means of improving board effectiveness and efficiency, in areas where more focused, specialized and technical discussions are required. These committees prepare the groundwork for decision-making and report at the subsequent board meeting. Committees enable better management of full board’s time and allow in-depth scrutiny and focused attention.

However, the Board of Directors is ultimately responsible for the acts of the committee. Board is responsible for defining the committee role and structure.

The structure of a board and the planning of the board’s work are key elements to effective governance. Establishing committees is one way of managing the work of the board, thereby strengthening the board’s governance role. Boards should regularly review its own structure and performance and whether it has the right committee structure and an appropriate scheme of delegation from the board.

Committees may be formed for a range of purposes, including:

- **Selection Committee/Nomination Committee**: To select Board members, to select a CEO, to select key managerial and senior management personnel
- **Board development or Governance Committee**: To look after/administer/support Board members and committee members and other executive positions
- **Investment Committee**: For advising to the board for investments
- **Risk Management Committee**: To report to the board about potential risks factor and to suggest action point for risk mitigation.
- **Safety, Health & Environment Committee**: To take care of the safety measures, prevention and effective disposal of the hazardous materials during the course of manufacturing and taking of care of sustainability development.
- **Committee of Inquiry**: To inquire into particular questions (disciplinary, technical, etc.)
- **Finance or Budget Committees**: To be responsible for financial reporting, organising audits, etc.
- **Marketing and Public Relations Committees**: To identify new markets; build relationship with media and public, etc.

NEED FOR COMMITTEES

Board committees are pillars of corporate governance. Board committees with formally established terms of reference, criteria for appointment, life span, role and function constitute an important element of the governance process and should be established with clearly agreed reporting procedures and a written scope of authority. A Board can either delegate some of its powers to the committee, enabling it to act directly, or can require the recommendations of the committee to be approved by the Board. Committees thus enable better management of the board’s time and allow in-depth scrutiny and focused attention.

The committees focus accountability to known groups. The Board will normally depend heavily on the
findings and recommendations of its committees, although final decisions to accept or reject these recommendations will be made by the Board.

Committees thus have an important role -

- to strengthen the governance arrangements of the company and support the Board in the achievement of the strategic objectives of the company;
- to strengthen the role of the Board in strategic decision making and supports the role of non-executive directors in challenging executive management actions;
- to maximise the value of the input from non-executive directors, given their limited time commitment;
- to support the Board in fulfilling its role, given the nature and magnitude of the agenda.

Committees need clear goals, objectives, and terms of reference in order to function efficiently, and Boards should ensure that these are developed before establishing the committee. Many committees have been known to work outside their intended purpose due to a lack of precise objectives.

**Rational behind Board Committees**

(a) To improve Board effectiveness and efficiency

(b) Minor details needs to be evaluated/analysed to arrive at a logical conclusion- This requires body having expertise in subject matter, a Board Committee shall in such cases assist the Board and give well considered recommendations to the Board. e.g. Audit Committee go through minor details of internal audit reports which is not possible and give suitable recommendations, this is not possible for entire Board to consider.

(c) Insulate Board from potential undue influence of controlling shareholders and managers

(d) Committees prepare groundwork for decision making and submit their recommendations to the Board for decision making

(e) Enables better management of Board’s time and allows in-depth scrutiny of proposals

(f) Establishing committees is one way of managing the work of the Board and strengthening the Board’s governance role.

**Mandatory Committees of the Board**

Mandatory committees of the Board are prescribed under:

<table>
<thead>
<tr>
<th>Companies Act, 2013</th>
<th>SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015</th>
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</thead>
<tbody>
<tr>
<td>For certain classes of companies</td>
<td>For listed companies</td>
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</table>
Audit Committee

Audit Committee is one of the main pillars of the corporate governance mechanism in any company. The Committee is charged with the principal oversight of financial reporting and disclosure and aims to enhance the confidence in the integrity of the company’s financial reporting, the internal control processes and procedures and the risk management systems.

The constitution of Audit Committee is mandated under the Companies Act 2013 and SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Under the Companies Act, 2013, the Audit Committee’s mandate is significantly different from what was laid down under Section 292A of the Companies Act 1956, and its scope and constitution have also been broadened.

### Constitution of Audit Committee

Section 177(1) of the Companies Act, 2013 provides that the Board of Directors of every listed public company and such other class or classes of companies, as may be prescribed, shall constitute an Audit Committee.

As per Notification No. GSR 8(E), dated 4-1-2017: In case of an unlisted public company which is licensed to operate by RBI or SEBI or IRDA from the International Financial Services Centre located in an approved multi services SEZ set-up under the SEZ Act, section 177 shall not apply.

Rule 6 of the Companies (Meetings of Board & its Powers) Rules, 2014 states that the Board of directors of every listed public company and a company covered under rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014 shall constitute an ‘Audit Committee’ and a ‘Nomination and Remuneration Committee of the Board’.

Rule 4(1) of *Companies (Appointment and Qualification of Directors) Rules, 2014* read with Rule 6 of the Companies (Meetings of the Board and is Powers) Rules, 2014 provides that the Board of directors of following companies are required to constitute a Audit Committee of the Board-

1. All listed public companies
2. All public companies with a paid up capital of 10 crore rupees or more;
3. All public companies having turnover of 100 crore rupees or more;

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<table>
<thead>
<tr>
<th>Mandatory Committees under the Companies Act, 2013</th>
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<tbody>
<tr>
<td>• Audit Committee</td>
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<td>• Nomination and Remuneration Committee</td>
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<tr>
<td>• Stakeholders Relationship Committee</td>
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<td>• Corporate Social Responsibility Committee</td>
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<th>Mandatory Committees under the SEBI (LODR) Regulations, 2015</th>
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</tr>
<tr>
<td>• Stakeholders Relationship Committee</td>
</tr>
<tr>
<td>• Risk Management Committee</td>
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(iv) All public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding 50 crore rupees or more.

Case Law: In the case of *Shruti Power Projects (P.) Ltd., In re, the National Company Law Tribunal*, Ahmedabad Bench, CP No. 5/441/NCLT/AHM/2017, dated April 13, 2017, opined that where company had constituted audit committee and complied with requirement under section 177 though belatedly and punishment provided for said violation was fine only, application of company for compounding offence under said section was to be allowed.

Regulation 18(1) of SEBI Listing Regulations, 2015 provides that every listed entity shall constitute a qualified and independent audit committee in accordance with the terms of reference, subject to the following:

a. The audit committee shall have minimum three directors as members.

b. Two-thirds of the members of audit committee shall be independent directors.

c. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

Explanation (1).- For the purpose of this regulation, “financially literate” shall mean the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Explanation (2).- For the purpose of this regulation, a member shall be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual’s financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

d. The chairperson of the audit committee shall be an independent director and he shall be present at Annual general meeting to answer shareholder queries.

e. The Company Secretary shall act as the secretary to the audit committee.

f. The audit committee at its discretion shall invite the finance director or head of the finance function, head of internal audit and a representative of the statutory auditor and any other such executives to be present at the meetings of the committee:

Provided that occasionally the audit committee may meet without the presence of any executives of the listed entity.

Composition of the Audit Committee

<table>
<thead>
<tr>
<th>Section 177(2) of the Companies Act, 2013</th>
<th>Regulation 18(1) of the SEBI (Listing Obligations and Disclosure Requirement) Regulations, 2015</th>
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<tr>
<td>Audit Committee shall consist of a minimum of three directors. Provided that majority of members of Audit Committee including its Chairperson shall be</td>
<td>Audit Committee shall have minimum three directors as members.</td>
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<td>persons with ability to read and understand, the financial statement.</td>
<td>Independent directors should form a majority. (Not applicable for Section 8 companies vide notification no. GSR 466(E), dated 5-6-2015)</td>
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<td>Majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand the financial statement.</td>
<td>All members of audit committee shall be financially literate and at least 1 (one) member shall have accounting or related financial management expertise. Explanation (1).- For the purpose of this regulation, “financially literate” shall mean the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows. Explanation (2).- For the purpose of this regulation, a member shall be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.</td>
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<td>The chairperson of the audit committee shall be an independent director and he shall be present at AGM to answer shareholder queries.</td>
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<th>auditor and any other such executives to be present at the meetings of the committee:</th>
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Note: “Financially literate” shall mean the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows. A member shall be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual’s financial sophistication, including being or having been a CEO, CFO or other senior officer with financial oversight responsibilities.

**Functions/Role of the Audit Committee**

**1) Under Section 177(4) of the Companies Act, 2013**

Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board. Terms of reference as prescribed by the board shall *inter alia*, include, –

(a) the recommendation for appointment, remuneration and terms of appointment of auditors of the company;

*b) In case of Government Companies, in Clause (1) of sub-section (4) of the section 177, for the words” recommendation for appointment, remuneration and terms of appointment “the words “recommendation for remuneration” shall be substituted- Notification No. GSR 463(E) dated 05-06-2015*

(b) review and monitor the auditor’s independence and performance, and effectiveness of audit process;

(c) examination of the financial statements and the auditors’ report thereon;

(d) approval or any subsequent modification of transactions of the company with related parties;

Provided that the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as prescribed under rule 6A of the Companies (meetings of board and its powers) rules, 2014;

Provided further that in case of transaction, other than transactions referred to in section 188, and where Audit Committee does not approve the transaction, it shall make its recommendations to the Board:

Provided also that in case any transaction involving any amount not exceeding one crore rupees is entered into by a director or officer of the company without obtaining the approval of the Audit Committee and it is not ratified by the Audit Committee within three months from the date of the transaction, such transaction shall be voidable at the option of the Audit Committee and if the transaction is with the related party to any director or is authorised by any other director, the director concerned shall indemnify the company against any loss incurred by it:

Provided also that the provisions of this clause shall not apply to a transaction, other than a transaction referred to in section 188, between a holding company and its wholly owned subsidiary company.
(e) scrutiny of inter-corporate loans and investments;

(f) valuation of undertakings or assets of the company, wherever it is necessary;

(g) evaluation of internal financial controls and risk management systems;

(h) monitoring the end use of funds raised through public offers and related matters.

(2) Under Regulation 18(3) SEBI Listing Regulations, 2015

The role of the audit committee and the information to be reviewed by the audit committee shall be as specified in Part C of Schedule II. The Part C of Schedule II is as under:

A. The role of the audit committee shall include the following:

1. Oversight of the listed entity's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible;

2. Recommendation for appointment, remuneration and terms of appointment of auditors of the listed entity;

3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors;

4. Reviewing, with the management, the annual financial statements and auditor's report thereon before submission to the board for approval, with particular reference to:
   (a) matters required to be included in the director’s responsibility statement to be included in the board’s report in terms of clause (c) of sub-section (3) of Section 134 of the Companies Act, 2013;
   (b) changes, if any, in accounting policies and practices and reasons for the same;
   (c) major accounting entries involving estimates based on the exercise of judgment by management;
   (d) significant adjustments made in the financial statements arising out of audit findings;
   (e) compliance with listing and other legal requirements relating to financial statements;
   (f) disclosure of any related party transactions;
   (g) modified opinion(s) in the draft audit report;

5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval;

6. Reviewing, with the management, the statement of uses / application of funds raised through an issue (public issue, rights issue, preferential issue, etc.), the statement of funds utilized for purposes other than those stated in the offer document / prospectus / notice and the report submitted by the monitoring agency monitoring the utilisation of proceeds of a public or rights issue, and making appropriate recommendations to the board to take up steps in this matter;

7. Reviewing and monitoring the auditor’s independence and performance, and effectiveness of audit process;

8. Approval or any subsequent modification of transactions of the listed entity with related parties;

9. Scrutiny of inter-corporate loans and investments;

10. Evaluation of undertakings or assets of the listed entity, wherever it is necessary;
11. Evaluation of internal financial controls and risk management systems;

12. Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems;

13. Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit;

14. Discussion with internal auditors of any significant findings and follow up there on;

15. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board;

16. Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern;

17. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non-payment of declared dividends) and creditors;

18. To review the functioning of the whistle blower mechanism;

19. Approval of appointment of chief financial officer after assessing the qualifications, experience and background, etc. of the candidate;

20. Carrying out any other function as is mentioned in the terms of reference of the audit committee.

21. Reviewing the utilization of loans and/or advances from/investment by the holding company in the subsidiary exceeding rupees 100 crore or 10% of the asset size of the subsidiary, whichever is lower including existing loans/advances/investments existing as on the date of coming into force of this provision. [Inserted by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. 1-4-2019]

B. The audit committee shall mandatorily review the following information:

1. management discussion and analysis of financial condition and results of operations;

2. statement of significant related party transactions (as defined by the audit committee), submitted by management;

3. management letters / letters of internal control weaknesses issued by the statutory auditors;

4. internal audit reports relating to internal control weaknesses; and

5. the appointment, removal and terms of remuneration of the chief internal auditor shall be subject to review by the audit committee.

6. statement of deviations:
   a. quarterly statement of deviation(s) including report of monitoring agency, if applicable, submitted to stock exchange(s) in terms of Regulation 32(1)
   b. annual statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice in terms of Regulation 32(7).

Remarks: The role of audit committee as prescribed in Regulation 18(3) of Part A of SEBI(LODR)
Regulations is of inclusive functions and not exhaustive. Any other functions may be entrusted by the Board of Directors to the Audit Committee. However, Part B prescribes the mandatory functions, which are essentially to be addressed by the Audit Committee of Board.

**Powers of the Audit Committee**

<table>
<thead>
<tr>
<th>Section 177 (5) and (6) of the Companies Act, 2013</th>
<th>Regulation 18(2)(c) of the SEBI Listing Regulations, 2015</th>
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<tbody>
<tr>
<td>The Audit Committee has the power to call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company. [Section 177(5)]</td>
<td>The audit committee shall have powers to investigate any activity within its terms of reference, seek information from any employee, obtain outside legal or other professional advice and secure attendance of outsiders with relevant expertise, if it considers necessary.</td>
</tr>
<tr>
<td>The Audit Committee shall have authority to investigate into any matter in relation to the items specified in terms of reference or referred to it by the Board and for this purpose the Committee has power to obtain professional advice from external sources. The Committee for this purpose shall have full access to information contained in the records of the company. [Section 177(6)]</td>
<td></td>
</tr>
<tr>
<td>The auditors of a company and the key managerial personnel shall have a right to be heard in the meetings of the Audit Committee when it considers the auditor’s report but shall not have the right to vote.[Section 177(7)]</td>
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</tr>
</tbody>
</table>

**Number of Meetings and Quorum:**

SEBI Listing Regulations, 2015 provides for the minimum number of meetings and quorum of the audit committee.

(i) The Audit Committee of a listed entity shall meet at least four (4) times in a year and not more than 120 shall elapse between two meetings. [Regulation 18(2)(a)]

(ii) The quorum for audit committee meeting shall either be:

- 2 members or
- 1/3rd of the members of the audit committee, whichever is greater;

with at least 2 independent directors. [Regulation 18(2)(b)]

The requirement of minimum 2 independent directors in the meeting of Audit Committee is new provision which must be complied by all the listed entities.

**Disclosure in Board’s Report**

Section 177(8) of the Act provides that the board’s report shall disclose following –
• Composition of an Audit Committee

• Where the Board had not accepted any recommendation of the Audit Committee, the same shall be disclosed in the report along with the reasons therefor.

**NOMINATION AND REMUNERATION COMMITTEE**

The Companies Act, 1956 had not mandated any committee relating to the appointment, nomination or remuneration of a director. However, there was a provision where public companies having no profits or inadequate profits and would like to remunerate the directors has to constitute a remuneration committee and such committee shall approve such remuneration to directors.

The Companies Act, 2013 (the Act) has introduced the provision of constitution of Nomination and Remuneration Committee.

**Constitution of the Committee**

Section 178(1) of the Act read with rule 6 of the Companies (Meetings of the Board and its Powers) Rules, 2014 and Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014, provides that the board of directors of following classes of companies is required to constitute a Nomination and Remuneration Committee of the Board-

(i) every listed public companies;

(ii) All public companies with a paid up capital of 10 crore rupees or more;

(iii) All public companies having turnover of 100 crore rupees or more;

(iv) All public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding 50 crore rupees or more.

Section 178 shall not apply to Section 8 companies are exempted vide Notification no. GSR 466(E), dated 05-06-2015.

Regulation 19(1) of the SEBI Listing Regulations, 2015 provides that the Board of all listed entity shall constitute the Nomination and Remuneration Committee.

**Composition**

<table>
<thead>
<tr>
<th>Section 178 of the Act</th>
<th>Regulation 19 of SEBI (LODR) Regulations, 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) The Board of Directors of every listed public company and such other class or classes of companies, as may be prescribed shall constitute the Nomination and Remuneration Committee consisting of three or more non-executive directors out of which not less than one half shall be independent directors:</td>
<td>(1) The board of directors shall constitute the nomination and remuneration committee as follows:</td>
</tr>
<tr>
<td><strong>Provided</strong> that the chairperson of the company (whether executive or non-executive) may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such Committee.</td>
<td>• the Committee shall comprise of at least 3 directors.</td>
</tr>
<tr>
<td></td>
<td>• all directors of the committee shall be non-executive directors; and</td>
</tr>
<tr>
<td></td>
<td>at least 50% of the directors shall be independent directors.</td>
</tr>
<tr>
<td></td>
<td>(2) The Chairperson of the nomination and remuneration committee shall be an independent director.</td>
</tr>
<tr>
<td></td>
<td><strong>Provided</strong> that the chairperson of the listed entity,</td>
</tr>
</tbody>
</table>
whether executive or non-executive, may be
appointed as a member of the Nomination and
Remuneration Committee and shall not chair such
Committee.

(2A) The quorum for a meeting of the nomination
and remuneration committee shall be either two
members or one third of the members of the
committee, whichever is greater, including at least
one independent director in attendance.

(3) The Chairperson of the nomination and
remuneration committee may be present at the
annual general meeting, to answer the
shareholders' queries; however, it shall be up to the
chairperson to decide who shall answer the
queries.

(3A) The nomination and remuneration committee
shall meet at least once in a year.

(4) The role of the nomination and remuneration
committee shall be as specified as in Part D of the
Schedule II

---

**Functions of the Committee**

(1) **Under Section 178(2), (3), and (4) of the Companies Act 2013**

The Nomination and Remuneration Committee shall perform following functions:

- 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 specify the manner for effective evaluation of performance of Board, its committees and individual directors to be carried out either by the Board, by the Nomination and Remuneration Committee or by an independent external agency and review its implementation and compliance [Section 178(2)]

- Formulate the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees. [Section 178(3)]

- While formulating the policy, the Committee shall consider the following:
  
  (a) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully;
  
  (b) relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and
  
  (c) remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals.
Provided that such policy shall be placed on the website of the company, if any, and the salient features of the policy and changes therein, if any, along with the web address of the policy, if any, shall be disclosed in the Board's report. [Section 178(4)]

Note: In case of Government Companies, section 178(2)/(3)/(4) shall not apply to Government company except with regard to appointment of ‘senior management’ and other employees - Notification No. GSR 463(E), dated 5-6-2015.

(2) Under Regulation 19(4) of SEBI (LODR) Regulations, 2015

The role of the Nomination and Remuneration committee shall include the following- (Part D, Schedule II)

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>formulation of the criteria for determining qualifications, positive attributes and independence of a director and recommend to the board of directors a policy relating to, the remuneration of the directors, key managerial personnel and other employees;</td>
</tr>
<tr>
<td>2</td>
<td>formulation of criteria for evaluation of performance of independent directors and the board of directors;</td>
</tr>
<tr>
<td>3</td>
<td>devising a policy on diversity of board of directors;</td>
</tr>
<tr>
<td>4</td>
<td>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 of directors their appointment and removal.</td>
</tr>
<tr>
<td>5</td>
<td>whether to extend or continue the term of appointment of the independent director, on the basis of the report of performance evaluation of independent directors.</td>
</tr>
<tr>
<td>6</td>
<td>recommend to the board, all remuneration, in whatever form, payable to senior [Inserted by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. 1-4-2019]</td>
</tr>
</tbody>
</table>

STAKEHOLDERS RELATIONSHIP COMMITTEE

Constitution / Composition of the Stakeholders Committee

<table>
<thead>
<tr>
<th>Section 178(5) of the Companies Act 2013</th>
<th>Regulation – 20 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Board of Directors of a company which consists of more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year shall constitute a Stakeholders Relationship Committee consisting of a chairperson who shall be a non-executive director and such other members as may be decided by the Board.</td>
<td>Stakeholders Relationship Committee. 20. (1) The listed entity shall constitute a Stakeholders Relationship Committee to specifically look into [various aspects of interest] of shareholders, debenture holders and other security holders. (2) The chairperson of this committee shall be a non-executive director. (2A) At least three directors, with at least one being an independent director, shall be members of the Committee. [Inserted by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. 1-4-2019].</td>
</tr>
</tbody>
</table>

1 Substituted for “the mechanism of redressal of grievances” the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. 1-4-2019.
Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. 1-4-2019]

neh 

[(3) The Chairperson of the Stakeholders Relationship Committee shall be present at the annual general meetings to answer queries of the security holders. ]

(3A) The stakeholders relationship committee shall meet at least once in a year. [Inserted by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. 1-4-2019 ]

(4) The role of the Stakeholders Relationship Committee shall be as specified as in Part D of the Schedule II.

Functions

The main function of the committee is to consider and resolve the grievances of security holders of the company.

The role of the Stakeholders Relationship Committee shall be to consider and resolve the grievances of the security holders of the listed entity including complaints related to transfer of shares, non-receipt of annual report and non-receipt of declared dividends. [Part B of Schedule II]

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

| (1) | Resolving the grievances of the security holders of the listed entity including complaints related to transfer/transmission of shares, non-receipt of annual report, non-receipt of declared dividends, issue of new/duplicate certificates, general meetings etc. |
| (2) | Review of measures taken for effective exercise of voting rights by shareholders. |
| (3) | Review of adherence to the service standards adopted by the listed entity in respect of various services being rendered by the Registrar & Share Transfer Agent. |
| (4) | Review of the various measures and initiatives taken by the listed entity for reducing the quantum of unclaimed dividends and ensuring timely receipt of dividend warrants/annual reports/statutory notices by the shareholders of the company. [Part B of Schedule II is substituted by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. 1-4-2019] |

CORPORATE SOCIAL RESPONSIBILITY COMMITTEE

Section 135 (1) read with rule 3 of Companies (Corporate Social Responsibility Policy) Rules, 2014, mandates that every company which fulfils any of the following criteria during any of the three preceding financial years shall constitute a CSR Committee -

- Companies having net worth of rupees five hundred crore or more, or
- Companies having turnover of rupees one thousand crore or more or

2 Substituted the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. 1-4-2019.
Companies having a net profit of rupees five crore or more

**Composition of the Committee**

- The CSR Committee shall consist of three or more directors.
- Atleast one director shall be an independent director.
- Companies (Meetings of Board and Powers) Rules, 2014, however, provides that-
  - an unlisted public company or a private company covered under sub-section (1) of section 135 which is not required to appoint an independent director, shall have its CSR Committee without such director.
  - a private company having only two directors on its Board shall constitute its CSR Committee with two such directors:
  - with respect to a foreign company covered under these rules, the CSR Committee shall comprise of at least two persons of which one person shall be as specified under clause (d) of subsection (1) of section 380 of the Act, i.e. the person resident in India authorized to accept on behalf of the company, service of process and any notices or other documents and another person shall be nominated by the foreign company.
- The composition of the CSR Committee shall be disclosed in the Board’s Report.

**Functions**

In accordance with section 135 the functions of the CSR committee include:

(a) formulating and recommending to the Board, a CSR Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII;

(b) recommending the amount of expenditure to be incurred on the CSR activities.

(c) monitoring the Corporate Social Responsibility Policy of the company from time to time.

(d) Further the rules provide that the CSR Committee shall institute a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the company.

**Other Committees**

In addition to the Committees of the Board mandated by the Companies Act, 2013 or SEBI (LODR) Companies may also constitute other Committees to oversee a specific objective or project. The nomenclature, composition and role of such Committees will vary, depending upon the specific objectives and nature of business of the company. A few examples of such Committees prevalent in the corporate sector in India and abroad are given below:

**Risk Management Committee**

A company needs to have a proactive approach to convert a risk into an opportunity. It is important for the company to have a structured framework to satisfy that it has sound policies, procedures and practices in place to manage the key risks under risk framework of the company. A risk management Committee’s role is to assist the Board in establishing risk management policy, overseeing and monitoring its implementation.
Regulation 21 of the SEBI (LODR) 2015 deals with the Risk Management Committee and provides as under:

1. The board of directors shall constitute a Risk Management Committee.

2. The majority of members of Risk Management Committee shall consist of members of the board of directors.

3. The Chairperson of the Risk management committee shall be a member of the board of directors and senior executives of the listed entity may be members of the committee.

3A. The risk management committee shall meet at least once in a year. [Inserted by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. 1-4-2019 ]

4. The board of directors shall define the role and responsibility of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit; such function shall specifically cover cyber security.

5. The provisions of this regulation shall be applicable to top 500 listed entities, determined on the basis of market capitalisation, as at the end of the immediate previous financial year.

**Corporate Governance Committee**

The Corporate Governance Committee is responsible for considering and making recommendations to the Board concerning the appropriate size, functions and needs of the Board. The Corporate Governance Committee may, at its sole discretion, engage director search firms and has the sole authority to approve the fees and other retention terms with respect to any such firms. The Corporate Governance Committee also has the authority, as necessary and appropriate, to consult with other outside advisors to assist in its duties to the Company.

A company may constitute this Committee to develop and recommend the board a set of corporate governance guidelines applicable to the company, implement policies and processes relating to corporate governance, to review, periodically, the corporate governance guidelines of the company. Many companies give the mandate of corporate governance to nomination committee and is given the nomenclature Nomination and Corporate Governance Committee.

Typically, the committee may be responsible for considering matters relating to corporate governance including the composition of board, appointment of new directors, review of strategic human resource decisions, succession planning for the chairman and other key board and executive positions, performance evaluation of the board and its committees and individual directors.

**Regulatory, Compliance & Government Affairs Committee**

The primary objective of the Compliance Committee is to review, oversee, and monitor:

- the Company’s compliance with applicable legal and regulatory requirements,
- the Company’s policies, programmes, and procedures to ensure compliance with relevant laws, the Company’s Code of Conduct, and other relevant standards;
- the Company’s efforts to implement legal obligations arising from settlement agreements and other similar documents; and
- perform any other duties as are directed by the Board of Directors of the company.
The committee oversees the Company’s non-financial compliance programmes and systems with respect to legal and regulatory requirements. Besides, it also oversees compliance with any ongoing Corporate Integrity Agreements or any similar undertakings by the Company with a government agency. Section 134 (5) of the Act dealing with Directors Responsibility Statement states that the directors need to ensure that they have devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively. Essentially, this responsibility ought to be the bulwark of the charter of this committee.

**ICSI Recommendations to strengthen Corporate Governance framework suggests** for constitution of Corporate Compliance Committee on mandatory basis in respect of all public limited companies having a paid –up capital of Rs.5 crore or more.

The charter of the committee may include:

- To oversee the Company’s compliance efforts with respect to relevant Company policies, the Company’s Code of Conduct, and other relevant laws and regulations and monitor the Company’s efforts to implement legal obligations arising from agreements and other similar documents;
- To review the Company’s overall compliance programme to ensure that it is well communicated, supports lawful and ethical business conduct by employees, and reduces risk to the Company for non-compliance with laws and regulations related to the Company’s business;
- To review complaints received from internal and external sources, regarding matters other than the financial matters which are within the purview of the Audit Committee;
- To periodically present to the Board for adoption appropriate changes to the policies, and oversee implementation of and compliance with these policies;
- To review regularly the company’s compliance risk assessment plan;
- To investigate or cause to be investigated any significant instances of non-compliance, or potential compliance violations that are reported to the committee;
- To coordinate with other committees regarding matters brought to the committees attention that relate to issues of compliance with applicable laws and regulations;
- Regularly report to the Board on the Committee’s activities, recommendations and conclusions;
- To discuss any significant compliance issues with the Chief Executive officer;
- To periodically report to the Board and CEO on the adequacy and effectiveness of the company’s compliance programme;
- To retain at the company’s expense, independent advisors to assist the committee with carrying out its responsibilities from time to time;
- To perform such other duties and responsibilities as may be assigned to the committee by the board.

**Other than those duties and responsibilities mentioned in the recommendatory charter following may also be the duties and responsibilities that can be delegated to the committee:**

- Review and monitor the Company’s compliance training initiatives on various topics, including but not limited to acceptable forms of compensation, conflicts of interest, competition and trade practices.
- Review the policies, programmes and procedures for ensuring compliance with relevant laws, the
Company’s Code of Conduct, value statement, other relevant standards, and legal obligations, including those imposed by settlement agreements.

- Present to the Board for adoption policies, periodically present to the Board for adoption appropriate changes to the policies, and oversee implementation of and compliance with these policies.
- Review and reassess the Charter’s adequacy, as appropriate, and recommend any proposed changes to the Board for approval.
- Reviews the organization, implementation and effectiveness of the Company’s health care compliance & ethics and quality & compliance programs.
- Oversees the Company’s Policy on Business Conduct and Code of Business Conduct & Ethics for Members of the Board of Directors and Executive Officers.
- Reviews the Company’s governmental affairs policies and priorities and other public policy issues facing the Company.
- Reviews the policies, practices and priorities for the Company’s political expenditure and lobbying activities.

**Science, Technology & Sustainability Committee**

Science, Technology & Sustainability Committee may be constituted to

- Monitor and review the overall strategy, direction and effectiveness of the Company’s research and development.
- Serve as a resource and provide input, as needed, regarding the scientific and technological aspects of product safety matters.
- Review the Company’s policies, programmes and practices on environment, health, safety and sustainability.
- Assist the Board in identifying and comprehending significant emerging science and technology policy and public health issues and trends that may impact the Company’s overall business strategy.
- Assist the Board in its oversight of the Company’s major acquisitions and business development activities as they relate to the acquisition or development of new science or technology.

**Customer Service Committee / Customer Grievance Committee**

Some service oriented companies may have separate Board Committee on customer service matters. Grievance committee may look after the complaints (if any) received from the customer and the steps taken to resolve it.

**Fraud Monitoring Committee**

Although the fraud related aspects may be taken care of by the Audit Committee, but in some companies which are in field of financial services, there may be need of the separate fraud monitoring committee, which may take care of the checks and balances and preventive measures in order to discourage the employees in their modus operandi.

**Information Technology Committee**

Information Technology is need of hour. This committee may look after the present and future need of the induction of Information Technology and also takes care of need of providing the training to the existing as well new incumbents.
Performance Appraisal Review Committee

This committee periodically (say annually) reviews the performance to Top Executives/ Key Managerial Person of the company as well as the Directors of the company. It is just like the performance review of the each and every employee, which happens in most of the organizations. By this annual exercise, the persons sitting at helm of the affairs of the company comes under the scanner of this committee.

GLOSSARY OF TECHNICAL WORDS

Audit Committee: An audit committee is a selected number of members of a company's board of directors whose responsibilities include helping auditors remain independent of management. Most audit committees are made up of three to five or sometimes as many as seven directors who are not a part of company management.

Corporate Social Responsibility Committee: The Corporate Social Responsibility Committee (the "Committee") is appointed by the Board of Directors (the "Board") to promote a culture that emphasizes and sets high standards for corporate social responsibility and reviews corporate performance against those standards.

Independent Director: An independent director (also sometimes known as an outside director) is a director (member) of a board of directors who does not have a material or pecuniary relationship with company or related persons, except sitting fees.

Government Company: A “Government company” is defined under Section 2(45) of the Companies Act, 2013 as “any company in which not less than 51% of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.”

Fraud monitoring Committee: Pursuant to the directions of the RBI, the Bank has constituted a Fraud Monitoring Committee, exclusively dedicated to the monitoring and following up of cases of fraud involving amounts of ₹1,00,00,000/- (Rupees One Crore Only) and above. The objectives of this Committee are the effective detection of frauds and immediate reporting of the frauds and actions taken against the perpetrators of frauds to the concerned regulatory and enforcement agencies.

LESSON ROUND UP

- A Board Committee is a small working group identified by the Board, consisting of Board members for the purpose of supporting the Board’s work.
- To enable better and more focused attention on the affairs of the Corporation, the board delegates particular matters to committees of the board set up for the purpose.
- Committees are usually formed as a means of improving board effectiveness and efficiency, in areas where more focused, specialized and technical discussions are required.
- Committees prepare the ground work for decision-making and report at the subsequent Board meeting.
- Audit committee is one of the main pillars of the corporate governance mechanism in any company. The committee is charged with the principal oversight of financial reporting and disclosures and enhance the confidence in the integrity of the company’s financial reporting and disclosure and aims to
the internal control processes and procedures and the risk management systems.

- Greater specialization and intricacies of modern board work is one of the reasons for increased use of board committees.

- Mandatory committees under Companies Act 2013 are Audit Committee, Nomination and Remuneration Committee, stakeholders Relationship committee, CSR Committee.

- Other committees – Corporate Governance Committee, Compliance Committee, Risk Management Committee, Ethics Committee, Strategies Committee, Capital Expenditure (Capex) Committee, etc.

- Nomination and Remuneration Committee: Nomination and Remuneration Committee as the name suggests is constituted by a company is to determine the qualification and remuneration packages of executive directors/ chief executive officers.

- Corporate Governance Committee: A company may constitute this committee to develop and recommend the board a set of corporate governance guidelines applicable to the company, implement policies and processes relating to corporate governance principles, to review, periodically, the corporate governance guidelines of the company.

- Corporate Compliance Committee: The primary objective of the Compliance Committee is to review, oversee, and monitor the Company’s compliance with applicable legal and regulatory requirements, its policies, programs, and procedures to ensure compliance with relevant laws, its Code of Conduct, and other relevant standards.

- Risk Management Committee: A business is exposed to various kind of risk such as strategic risk, data-security risk, fiduciary risk, credit risk, liquidity risk, reputational risk, environmental risk, competition risk, fraud risk, technological risk etc. A risk management Committee’s role is to assist the Board in establishing risk management policy, overseeing and monitoring its implementation.

### SELF TEST QUESTIONS

1. What is the need and what are the advantages of Committee Management?
2. Discuss in detail about nomination and remuneration committee.
3. Explain the importance of constitution of Risk Management Committee?
4. Discuss in detail about Audit Committee.
Lesson 6
Corporate Governance and Shareholders Rights

LESSON OUTLINE

• Introduction
• Rights of Shareholders
• Protection of Rights of Minority Shareholders
• Challenges in exercising shareholders rights
• Investor Protection in India
• Shareholder Activism
• Investor Relations
• OECD Principles of Corporate Governance
• Role of Institutional Investors in promoting good Corporate Governance
• Institutional Investors – Global Trends
• Tools used by Institutional Investors
• Conclusion
• Glossary
• Lesson Round Up
• Self Test Questions

LEARNING OBJECTIVES

The objective of this study lesson is to enable the students to understand what the rights of the shareholders are and how it is important from corporate governance perspective.

In this study lesson, the rights of shareholders as recommended in the OECD Principles on Corporate Governance and the provisions in the Companies Act, 2013 and the Listing Agreement which deals with shareholder rights have been covered. The challenges in exercising the shareholders rights have also been discussed.

The Study covers how the interests of minority shareholders may be protected in light of related party transactions; the study explains about shareholder activism and the role that institutional shareholders can play in prompting good corporate governance. To enable student to understand the global trends on the subject, international codes like UK Stewardship Code, UN Principles on Responsible Investment, The Code for Responsible Investing in South Africa (CRISA), CALpers corporate engagement process have been covered.

“Committees have become so important nowadays that subcommittees have to be appointed to do the work”- Laurence J. Peter
Protection of shareholder rights is sacrosanct for good corporate governance. It is one of the pillars of corporate governance. For the efficient functioning of the capital market, the fundamental requirement is that the investor rights are well protected. The Preamble to Securities and Exchange Board of India Act, 1992 reads as under:

“An Act to provide for the establishment of a Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto.”

The central element in corporate governance is the challenges arising out of separation of ownership and control. The shareholders are the true owners of a corporate and the governance function controls the operations of the corporate. There is a strong likelihood that there is a mismatch between the expectations of the shareholders and the actions of the management. Therefore there is a need to lay down clearly the rights of the shareholders and that of the management.

In the Indian context, the SEBI Act, 1992, the various SEBI Regulations and Guidelines and the Companies Act, 2013 enables the empowerment of shareholder rights.

In the international context, the OECD Principles on Corporate Governance which serves as an international benchmark for policy makers, investors, corporations and other stakeholders worldwide also has made extensive recommendations as to the shareholder rights.

### RIGHTS OF SHAREHOLDERS

#### 2.1. Under the Companies Act, 2013

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Rights of Shareholder</th>
<th>Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td><strong>Right to receive copies of the following documents:</strong></td>
<td></td>
</tr>
<tr>
<td>i</td>
<td>Abridged balance-sheet and profit and loss account in the case of a listed company and balance-sheet and profit and loss account otherwise.</td>
<td>136</td>
</tr>
<tr>
<td>ii</td>
<td>Contract for the appointment of the Managing Director / Manager</td>
<td>190</td>
</tr>
<tr>
<td>iii</td>
<td>Notices of the general meetings of the company</td>
<td>101</td>
</tr>
<tr>
<td>2.</td>
<td><strong>Right to inspect statutory registers/returns and get copies thereof on payment of prescribed fees.</strong></td>
<td></td>
</tr>
<tr>
<td>i</td>
<td>Debenture Trust Deed</td>
<td>71, 71(13)</td>
</tr>
<tr>
<td>ii</td>
<td>Register of Charges</td>
<td>87</td>
</tr>
<tr>
<td>iii</td>
<td>Register of Members and Debenture holders and Index Registers, Annual Returns</td>
<td>94</td>
</tr>
<tr>
<td>iv</td>
<td>Minutes of General Meetings</td>
<td>119</td>
</tr>
<tr>
<td>v</td>
<td>Register of Contracts</td>
<td>189</td>
</tr>
</tbody>
</table>
3. Right to attend Meetings of the Shareholders and exercise voting rights at these meetings either personally or through proxy.

4. Other Rights:

i. To receive share certificates as title of their holdings

ii. To transfer shares

iii. To receive dividend when declared

iv. To have right shares

v. To appoint directors

vi. To share the surplus assets on winding up

vii. Right to be exercised collectively in respect of making application to the Central government for investigation of the affairs of the company.

viii. Right to make application collectively to the Company Law Board/ Tribunal for oppression and mismanagement

ix. Right of Nomination

x. Right to vote in proportion to his share of the paid-up equity share capital of the company

xi. Variation of Shareholder’s right

5. In case of winding up:

I. Winding up of a company in case of oppression and mismanagement

Rights of Shareholder under the SEBI (Prohibition of Insider Trading) Regulations 2015

Chapter II deals with the Restrictions on Communication and Trading by Insiders. Regulation 3(3) provides that Notwithstanding anything contained in this regulation, an unpublished price sensitive information may be communicated, provided, allowed access to or procured, in connection with a transaction that would:

(i) entail an obligation to make an open offer under the takeover regulations where the board of directors of the company is of informed opinion that the proposed transaction is in the best interests of the company;

Note: It is intended to acknowledge the necessity of communicating, providing, allowing access to or procuring UPSI for substantial transactions such as takeovers, mergers and acquisitions involving trading in securities and change of control to assess a potential investment. In an open offer under the takeover regulations, not only would the same price be made available to all
shareholders of the company but also all information necessary to enable an informed divestment or retention decision by the public shareholders is required to be made available to all shareholders in the letter of offer under those regulations.

(ii) not attract the obligation to make an open offer under the takeover regulations but where the board of directors of the company is of informed opinion that the proposed transaction is in the best interests of the company and the information that constitute unpublished price sensitive information is disseminated to be made generally available at least two trading days prior to the proposed transaction being effected in such form as the board of directors may determine.

Note: It is intended to permit communicating, providing, allowing access to or procuring UPSI also in transactions that do not entail an open offer obligation under the takeover regulations if it is in the best interests of the company. The board of directors, however, would cause public disclosures of such unpublished price sensitive information well before the proposed transaction to rule out any information asymmetry in the market.

Rights of shareholders under SEBI (LODR) Regulations, 2015

Chapter II deals with the principles governing disclosures and obligations of listed entity; Regulation 4(2) states that the listed entity which has listed its specified securities shall comply with the corporate governance provisions as specified in chapter IV which shall be implemented in a manner so as to achieve the objectives of the principles as mentioned below.

(a) **The rights of shareholders:** The listed entity shall seek to protect and facilitate the exercise of the following rights of shareholders:

(i) right to participate in, and to be sufficiently informed of, decisions concerning fundamental corporate changes.

(ii) opportunity to participate effectively and vote in general shareholder meetings.

(iii) being informed of the rules, including voting procedures that govern general shareholder meetings.

(iv) opportunity to ask questions to the board of directors, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.

(v) Effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of board of directors.

(vi) exercise of ownership rights by all shareholders, including institutional investors.

(vii) adequate mechanism to address the grievances of the shareholders.

(viii) protection of minority shareholders from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and effective means of redress.

(b) **Timely information:** The listed entity shall provide adequate and timely information to shareholders, including but not limited to the following:

(i) sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be discussed at the meeting.

(ii) capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership.
(iii) rights attached to all series and classes of shares, which shall be disclosed to investors before they acquire shares.

(c) **Equitable treatment:** The listed entity shall ensure equitable treatment of all shareholders, including minority and foreign shareholders, in the following manner:

(i) All shareholders of the same series of a class shall be treated equally.

(ii) Effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of board of directors, shall be facilitated.

(iii) Exercise of voting rights by foreign shareholders shall be facilitated.

(iv) The listed entity shall devise a framework to avoid insider trading and abusive self-dealing.

(v) Processes and procedures for general shareholder meetings shall allow for equitable treatment of all shareholders.

(vi) Procedures of listed entity shall not make it unduly difficult or expensive to cast votes.

(d) **Role of stakeholders in corporate governance:** The listed entity shall recognise the rights of its stakeholders and encourage co-operation between listed entity and the stakeholders, in the following manner:

(i) The listed entity shall respect the rights of stakeholders that are established by law or through mutual agreements.

(ii) Stakeholders shall have the opportunity to obtain effective redress for violation of their rights.

(iii) Stakeholders shall have access to relevant, sufficient and reliable information on a timely and regular basis to enable them to participate in corporate governance process.

(iv) The listed entity shall devise an effective whistle blower mechanism enabling stakeholders, including individual employees and their representative bodies, to freely communicate their concerns about illegal or unethical practices.

PROTECTION OF RIGHTS OF MINORITY SHAREHOLDERS

Companies Act, 2013 provides for some measures to protect the interest of minority shareholders. It includes the following:

- Where a company, which has raised money from public through prospectus and still has any unutilized amount out of the money so raised and which proposes to change its objects, then the promoter and shareholders having control of a company are required to provide an exit to the dissenting shareholders in accordance with regulations to be specified by SEBI.

- Where any benefit accrues to promoter, director, manager, KMP, or their relatives, either directly or indirectly as a result of non-disclosure or insufficient disclosure in the explanatory statement annexed to the notice of general meeting then such persons shall hold such benefit in trust for the company and shall be liable to compensate the company to the extent of the benefit received by him.

- **Class Action Suit:** New concept of Class Action Suit has been introduced. In case of oppression / mismanagement, specified number of members or depositors is entitled to file Class Action Suit before NCLT for seeking prescribed reliefs. They may also claim damages / compensation for fraudulent / unlawful / wrongful acts from or against the company / directors / auditors / experts /
advisors etc. Some of the actions that can be taken are as under:

- Restrain company from any act which is ultra vires the AOA / MOA
- Restrain company for breach of provisions of MOA / AOA, Act or any other law
- Declare a resolution void if material facts are not provided
- Restrain company/ directors from acting on such resolutions
- Restrain company from taking action contrary to any resolution passed by shareholders
- Claim damages or compensation or demand any other suitable action
- Seek other remedies as Tribunal may deem fit

### CHALLENGES IN EXERCISING SHAREHOLDERS RIGHTS

**Principle III of the OECD Principles on Corporate Governance** states that the corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

The rights of shareholders have been well secured in the legislative framework. That is to say that the law is in place to secure the rights of the shareholders. All shareholders of the same class have the same rights. If that be so what is the challenge? In this section we will discuss the challenges.

Shareholders can be classified as dominant shareholders and minority shareholders. In general parlance dominant shareholders are those, who by virtue of their majority shareholding or their association with the company as its founders or for any other reason are able to exercise control in the management of the company.

One of the basic challenges in exercising the shareholder rights stems from information asymmetry between the dominant shareholders and the minority shareholders. This could be attributed to lack of timely disclosure of accurate information on important matters which is crucial for the protection of shareholders’ rights for two main reasons. First, shareholders need to have access to information about important matters to make decisions that are in their interests. Second, information disclosure is crucial in preventing managers and dominant shareholders from engaging in activities that are detrimental to minority shareholders.

Another major challenge arises on account of lack of awareness amongst the small shareholders as their rights leading towards a passive approach to voting.

### INVESTOR PROTECTION IN INDIA

Securities and Exchange Board of India (SEBI) is the capital market regulator and nodal agency in India who regulates the security market. One of the objectives of the SEBI is to provide a degree of protection to the investors and to safeguard their rights, steady flow of savings into market and to promote the development of and regulate the securities market.

**Investors should be safeguarded not only against frauds and cheating but also against the losses arising out of unfair practices. Such practices may include:**

- Deliberate misstatement in offer statements to investors
• Price manipulations
• Insider trading.

SEBI has issued many guidelines and regulations to regulate the capital market and to protect the investors. Some of the guidelines are:

• SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (Refer Para 2.2. of this lesson for details)
• SEBI (Ombudsman) Regulation 2003 – designed to redress the investor’s grievance against listed companies or intermediaries or both for amicable settlement;
• SEBI (Prohibition of fraudulent and unfair Trade Practices relating to securities market) Regulations 2003 – to prohibit any fraudulent and unfair Trade Practices relating to securities market;
• SEBI (Prohibition of Insider Trading) Regulations 2015. The basic objective is to prohibit persons who have more access to company’s information which can be used to benefit the individual or group of individual or agency.
• In addition to the above, SEBI has set up a separate cell to address the grievances of investors - SEBI Complaints Redressal System (SCORES).

Investor Education & Protection Fund: Investor Education and Protection Fund (IEPF) is established under section 125 of Companies Act, 2013.

Schedule II to the Investor Education and Protection Fund Authority (Appointment of Chairperson and Members, holding of Meetings and provisions for Offices and Officers) Rules, 2016 stipulate the broad functional divisions of the Authority including sanctioning grants to the registered entities for seminars, programmes, projects or activities in the field of Corporate Governance, Investors’ Education and Protection including research activities.

The Securities and Exchange Board of India (SEBI) also notified SEBI (Investor Protection and Education Fund) Regulations, 2009 according to which SEBI will establish an Investor Protection and Education Fund which will be used inter-alia, for “aiding investors’ associations recognized by the Board to undertake legal proceedings in the interest of investors in securities that are listed or proposed to be listed” – clause 5 (2) (d) of the Regulations. This amendment is a path-breaking one and is believed to set shareholder activism in India. Through this an attempt is being made to provide incentive to class action litigations. Though a regime has started yet much is needed to make such litigations successful in India.

Shareholders can ensure that the company follows good corporate governance practices and implements beneficial policies.

Shareholder activism refers to the active involvement of stockholders in their organization. Active participation in company meetings is a healthy practice. They can resolve issues laid down in the annual and other general meetings and can raise concerns over financial matters or even social causes such as protection of the environment. Shareholder activists include public pension funds, mutual funds, unions, religious institutions, universities, foundations, environmental activists and human rights groups.

A share in a company is not only a share in profits but also a share in ownership. Shareholders must realize that their active participation in the company’s operations ensures
A management that knows that it will be questioned and held responsible for its actions, is always on its feet.

The corporate crisis that looms today - shareholder activism - is with different actors but the same stories. In the 90’s it was hostile takeovers. Today it is hostile hedge funds frustrated with performance and employing new strategies to improve overall returns. Ironically, shorter term investors that once “voted with their feet” are now taking the long road of shareholder activism.

**History of Shareholder Activism**

Shareholder activism can be traced back 80 years when Henry Ford chose to cancel a special dividend and instead spend the money on advancing social objectives. The court ultimately sided with dissented shareholders, reinstated the dividend, sparking a new paradigm in shareholder activism.

In the late 1980’s, shareholder activism took a more aggressive turn with corporate raiders like Paul Getty. Shareholders took on management, The New Crisis: Shareholder Activism Ashton Partners engaging in hostile takeovers and leveraged-buyouts to gain control of undervalued and underperforming companies.

In the 1990’s shareholder activism found mainstream pension fund managers like CalPERS pushing for the repeal of staggered boards and poison pills. These players used a form of “quiet” activism – favoring abstentions and withholding votes for important proxy issues – as a way to influence management and Board decisions.

The purpose of shareholder activism is to

- Provide an overview of shareholder activist, and how it may influence a company’s behaviour,
- Identify what options are available for shareholders wishing to pursue an activist agenda, and
- Consider the legal framework in which UK public companies must operate when faced with shareholder activism.

Shareholder activism can be exercised through proxy battles, publicity campaigns, shareholder resolutions, litigation and negotiations with management. For example,

- Shareholder activism played a major role in eradicating apartheid in South Africa through divestment.
- Shareholders have also influenced the phasing out of polystyrene products at McDonalds.
- More recently, shareholders were able to bring public pressure and media attention on Home Depot to stop the use of wood from environmentally sensitive areas.

The shareholder activism means

- Establishing dialogue with the management on issues that concern
- Influencing the corporate culture.
- Using the corporate democracy provided by law.
- Increasing general awareness on social and human rights issues concerning the organization.

Internet and mass media are effective tools in building up pressure on the management.
Shareholder activism often highlights differences in strategy or poor communication. In numerous activist situations companies believing they've told one story, and the investment community hearing another, or nothing at all. Inconsistency in messaging and lack of information breed investor discontent, and ultimately shareholder activism. If ignored long enough, the situation comes to a breaking point where activist investors choose a drastic approach.

**INVESTOR RELATIONS (IR)**

Investor Relations (IR) is a strategic management responsibility that integrates finance, communication, marketing and securities law compliance to enable the most effective two-way communication between a company, the financial community, and other constituencies, which ultimately contributes to a company's securities achieving fair valuation.

Typically, investor relation is a department or person reporting to the Chief Financial Officer. In some companies, investor relation is managed by the public relations or corporate communications departments, and can also be referred to as “financial public relations” or “financial communications”.

Many larger publicly-traded companies now have dedicated IR officers (IROs), who oversee most aspects of shareholder meetings, press conferences, private meetings with investors, (known as "one-on-one" briefings), investor relations sections of company websites, and company annual reports. The investor relations function also often includes the transmission of information relating to intangible values such as the company's policy on corporate governance or corporate social responsibility. Recently, the field has trended toward an increasingly popular movement for "interactive data", and the management of company filings through streaming-data solutions such as XBRL or other forms of electronic disclosure have become prevalent topics of discussion amongst leading IROs worldwide.

The investor relations function must be aware of current and upcoming issues that an organization or issuer may face, particularly those that relate to fiduciary duty and organizational impact. In particular, it must be able to assess the various patterns of stock-trading that a public company may experience, often as the result of a public disclosure (or any research reports issued by financial analysts). The investor relations department must also work closely with the Company Secretary on legal and regulatory matters that affect shareholders.

IRO's have access to the Chief Executive Officer (CEO) and Chairman or President of the corporation. This means that being able to understand and communicate the company's financial strategy, they are also able to communicate the broader strategic direction of the corporation and ensure that the image of the corporation is maintained in a cohesive fashion.

Due to the potential impact of legal liability claims awarded by courts, and the consequential impact on the company's share price, IR often has a role in crisis management of, for example, corporate downsizing, changes in management or internal structure, product liability issues and industrial disasters.

The most highly-regarded professional member organization for Investor Relations in the United States is the National Investor Relations Institute, or NIRI. In the United Kingdom, the recognized industry body is The Investor Relations Society, while in Canada, the professional association is called the Canadian Investor Relations Institute, or CIRI. Australia's professional organization is known as the Australian Investor Relations Association (AIRA).
**ICSI Recommendations to strengthen Corporate Governance Framework** recommends Constitution of Investor Relations Cell should be made mandatory for Listed Companies. The Investor Relations Meet after declaration of financial results should be compulsorily webcast in case of companies having a market capitalization of Rs.1000 Crore or more.

**The Sarbanes-Oxley Act:** The Sarbanes-Oxley Act of 2002 significantly increased the importance of investor relations in the financial markets. The act established new requirements for corporate compliance and regulatory governance, with an increased emphasis on accuracy in auditing and public disclosure. Notable provisions of the act which apply to investor relations include enhanced financial disclosures and accuracy of financial reports, real-time disclosures, off-balance-sheet transaction disclosures, pro-forma financial disclosures, management assessment of internal controls, and corporate responsibility for financial reports. More specifically, Sarbanes-Oxley sections 301, 302, 404, and 802 have been of particular interest to companies improving corporate compliance. Similar to Sarbanes-Oxley are Bill 198 in Canada, LSF in France, and J-SOX in Japan. The European MiFID (Markets in Financial Instruments Directive), although principally concerned with investor protection, also covers regulation and compliance for listed European companies.

If the latest collection of balance sheets is any indication, corporate India is increasingly paying attention to investor relations, courtesy IROs whose roles are being fine-tuned like never before. Companies are strengthening their investor relations departments, multi-tasking them and hiring more people for improved investor communication.

**Reporting Standards:** Companies these days need to disclose much more. The current legal requirements are prompting companies to refine their reporting standards too. The job-profile of IROs is changing as a result. IROs provide definite inputs to boards of directors and become part of companies’ disclosure committees.

**Investor Confidence:** The responsibilities of the IRO, include:

- building interest in the firm on the buy side,
- anticipate market reaction towards M&As and divestitures,
- and building investor confidence in the firm.

Companies frequently need to convey important messages to shareholders, some of them related to performance and strategy, point out investment circles. “Communications these days is not merely about meetings with stakeholders.”

**OECD PRINCIPLES OF CORPORATE GOVERNANCE**

Good corporate governance is not an end in itself. It is a means to create market confidence and business integrity, which in turn is essential for companies that need access to equity capital for long term investment. Access to equity capital is particularly important for future oriented growth companies and to balance any increase in leveraging. The updated G20/OECD Principles of Corporate Governance (the Principles) therefore provide a very timely and tangible contribution to the G20 priority in 2015 to support investment as a powerful driver of growth.

The Principles are also about inclusiveness. Today, millions of households around the world have their savings in the stock market, directly or indirectly. And publicly listed companies provide for more than 200 million jobs. The Principles also address the rights of these stakeholders and their ability to participate in corporate wealth creation.
The Principles were originally developed by the OECD in 1999 and further updated in 2004. Following the request by the G20 Finance Ministers and Central Bank Governors at their meeting on 9-10 February 2015 in Istanbul, a draft of the revised Principles was presented and discussed at the G20/OECD Corporate Governance Forum in Istanbul on 10 April 2015 where they found broad support among participants. The Principles were subsequently presented at the May and August 2015 meetings of the G20 Investment and Infrastructure Working Group. The OECD Council adopted the Principles on 8 July 2015. The Principles are now submitted to the G20 Finance Ministers and Central Bank Governors meeting in Ankara 4-5 September for endorsement as joint G20/OECD Principles and transmission to the G20 Leaders Summit in November 2015.

The Principles provide guidance through recommendations and annotations across six chapters.

I. Ensuring the basis for an effective corporate governance framework:

The corporate governance framework should promote transparent and fair markets, and the efficient allocation of resources. It should be consistent with the rule of law and support effective supervision and enforcement:

- A. The corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and well-functioning markets.
- B. The legal and regulatory requirements that affect corporate governance practices should be consistent with the rule of law, transparent and enforceable.
- C. The division of responsibilities among different authorities should be clearly articulated and designed to serve the public interest.
- D. Stock market regulation should support effective corporate governance
- E. Supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfil their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained.
- F. Cross-border co-operation should be enhanced, including through bilateral and multilateral arrangements for exchange of information.

II. The rights and equitable treatment of shareholders and key ownership functions:

The corporate governance framework should protect and facilitate the exercise of shareholders’ rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights:

- A. Basic shareholder rights should include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant and material information on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect and remove members of the board; and 6) share in the profits of the corporation.
- B. Shareholders should be sufficiently informed about, and have the right to approve or participate in, decisions concerning fundamental corporate changes such as: 1) amendments to the statutes, or articles of incorporation or similar governing documents of the company; 2) the authorisation of additional shares; and 3) extraordinary transactions, including the transfer of all or substantially all assets, that in effect result in the sale of the company.
- C. Shareholders should have the opportunity to participate effectively and vote in general shareholder
meetings and should be informed of the rules, including voting procedures, that govern general shareholder meetings:

1. Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.

2. Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes.

3. Shareholders should have the opportunity to ask questions to the board, including questions relating to the annual external audit, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.

4. Effective shareholder participation in key corporate governance decisions, such as the nomination and election of board members, should be facilitated. Shareholders should be able to make their views known, including through votes at shareholder meetings, on the remuneration of board members and/or key executives, as applicable. The equity component of compensation schemes for board members and employees should be subject to shareholder approval.

5. Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.

6. Impediments to cross border voting should be eliminated.

D. Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse.

E. All shareholders of the same series of a class should be treated equally. Capital structures and arrangements that enable certain shareholders to obtain a degree of influence or control disproportionate to their equity ownership should be disclosed.

1. Within any series of a class, all shares should carry the same rights. All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any changes in economic or voting rights should be subject to approval by those classes of shares which are negatively affected.

2. The disclosure of capital structures and control arrangements should be required.

F. Related-party transactions should be approved and conducted in a manner that ensures proper management of conflict of interest and protects the interest of the company and its shareholders.

1. Conflicts of interest inherent in related-party transactions should be addressed.

2. Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.

G. Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress. Abusive self dealing should be prohibited.

H. Markets for corporate control should be allowed to function in an efficient and transparent manner.
1. The rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions such as mergers, and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class.

2. Anti-take-over devices should not be used to shield management and the board from accountability.

III. Institutional investors, stock markets, and other intermediaries:

The corporate governance framework should provide sound incentives throughout the investment chain and provide for stock markets to function in a way that contributes to good corporate governance:

A. Institutional investors acting in a fiduciary capacity should disclose their corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights.

B. Votes should be cast by custodians or nominees in line with the directions of the beneficial owner of the shares.

C. Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.

D. The corporate governance framework should require that proxy advisors, analysts, brokers, rating agencies and others that provide analysis or advice relevant to decisions by investors, disclose and minimise conflicts of interest that might compromise the integrity of their analysis or advice.

E. Insider trading and market manipulation should be prohibited and the applicable rules enforced.

F. For companies who are listed in a jurisdiction other than their jurisdiction of incorporation, the applicable corporate governance laws and regulations should be clearly disclosed. In the case of cross listings, the criteria and procedure for recognising the listing requirements of the primary listing should be transparent and documented.

G. Stock markets should provide fair and efficient price discovery as a means to help promote effective corporate governance.

IV. The role of stakeholders in corporate governance:

The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises:

A. The rights of stakeholders that are established by law or through mutual agreements are to be respected.

B. Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

C. Mechanisms for employee participation should be permitted to develop.

D. Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis.

E. Stakeholders, including individual employees and their representative bodies, should be able to
freely communicate their concerns about illegal or unethical practices to the board and to the competent public authorities and their rights should not be compromised for doing this.

F. The corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights.

V. Disclosure and transparency:

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company:

A. Disclosure should include, but not be limited to, material information on:

1. The financial and operating results of the company.
2. Company objectives and non-financial information.
3. Major share ownership, including beneficial owners, and voting rights.
4. Remuneration of members of the board and key executives.
5. Information about board members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board.
6. Related party transactions.
7. Foreseeable risk factors.
8. Issues regarding employees and other stakeholders.
9. Governance structures and policies, including the content of any corporate governance code or policy and the process by which it is implemented.

B. Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial reporting.

C. An annual audit should be conducted by an independent, competent and qualified, auditor in accordance with high-quality auditing standards in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.

D. External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.

E. Channels for disseminating information should provide for equal, timely and cost-efficient access to relevant information by users.

VI. The responsibilities of the board:

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board’s accountability to the company and the shareholders:

A. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

B. Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.
C. The board should apply high ethical standards. It should take into account the interests of stakeholders.

D. The board should fulfill certain key functions, including:

1. Reviewing and guiding corporate strategy, major plans of action, risk management policies and procedures, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.

2. Monitoring the effectiveness of the company’s governance practices and making changes as needed.

3. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.

4. Aligning key executive and board remuneration with the longer term interests of the company and its shareholders.

5. Ensuring a formal and transparent board nomination and election process.

6. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.

7. Ensuring the integrity of the corporation’s accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.

8. Overseeing the process of disclosure and communications.

E. The board should be able to exercise objective independent judgement on corporate affairs.

1. Boards should consider assigning a sufficient number of nonexecutive board members capable of exercising independent judgement to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are ensuring the integrity of financial and non-financial reporting, the review of related party transactions, nomination of board members and key executives, and board remuneration.

2. Boards should consider setting up specialised committees to support the full board in performing its functions, particularly in respect to audit, and, depending upon the company’s size and risk profile, also in respect to risk management and remuneration. When committees of the board are established, their mandate, composition and working procedures should be well defined and disclosed by the board.

3. Board members should be able to commit themselves effectively to their responsibilities.

4. Boards should regularly carry out evaluations to appraise their performance and assess whether they possess the right mix of background and competences.

F. In order to fulfil their responsibilities, board members should have access to accurate, relevant and timely information.

G. When employee representation on the board is mandated, mechanisms should be developed to facilitate access to information and training for employee representatives, so that this representation is exercised effectively and best contributes to the enhancement of board skills, information and independence.
ROLE OF INSTITUTIONAL INVESTORS IN PROMOTING GOOD CORPORATE GOVERNANCE

Institutional investors are financial institutions that accept funds from third parties for investment in their own name but on such parties' behalf. They include pension funds, mutual funds and insurance companies.

There is a difference of opinion among the writers on the role of Institutional Investors in promoting good corporate governance. Wharton, Lorsch, and Hanson (1991) argue that institutional investors need not take active interest in the corporate governance of a company because the institutional investors have their primary fiduciary responsibility to their own investors and beneficiaries, which can lead to a conflict of interest with their acting as owners. Admati, Pfleiderer and Zechner (1994), Black (1990), Coffee (1991), and Monks (1995) have argued that absence of appropriate incentives and free rider problems hinder institutional activism efforts. The free rider problem comes because even when one institutional investor interferes, the other investors get the benefits. Hence, the costs associated with active monitoring are borne by only one investor and this discourages active intervention. Charkham (1994) divides the institutional investors into two categories, which he calls Type A and Type B. Type A institutions have a portfolio of a very small number of companies. Their stake in each individual company is very large. These institutions also keep a close relationship with the companies. Type B institutions, on the other hand, manage a widely diversified portfolio. These companies treat the shares as commodities with no intrinsic qualities other than that of being tradable commodities. According to Charkham, corporate governance system fails because most institutions fall in the Type B category. Here only the Type A institutional investors have got an incentive for active monitoring for it directly affects the portfolio value. The above arguments are based on the premise that the investment objectives and the compensation system in the institutional investing companies often discourage their active participation in the corporate governance system of the companies. Another reason often cited by these people is that the institutional investors are not competent enough to interfere in the activities of the companies. Cordtz (1993) has argued that the institutional investors lack the expertise and ability to serve as effective monitors. The Cadbury committee (1992), for example, states that “because of their collective stake, we look to the institutions in particular, with the backing of the Institutional Shareholders’ Committee, to use their influence as owners to ensure that the companies in which they have invested comply with the code” (para 6.16). The working group on corporate governance of Harvard Business Review has, similarly, concluded "the institutional investors of public companies should see themselves as owners and not as investors. In India, the CII report on corporate governance has also brought out the importance of the role that the institutional investors can play in the corporate governance of a company. The Kumar Mangalam Birla committee on corporate governance (henceforth SEBI committee) similarly emphasizes the role that the institutional shareholders can play in the corporate governance system of a company. "... in view of the Committee is that, the institutional shareholders put to good use their voting power... ". These reports raise one interesting question that must be answered before we can comment on the role that the institutional investors should play in the corporate governance system of a company. Institutional investors are answerable to their investors the way the companies (in which they have invested) are answerable to their shareholders. And the shareholders do invest their funds with the institutional investors expecting higher returns. The primary responsibility of the institutional investors is therefore to invest the money of the investors in companies, which are expected to generate the maximum possible return rather than in companies with good corporate governance records. Most of the Corporate Governance reports ignore this aspect when they expect the institutional investors to play the role of an active investor\(^1\).

The Pros and Cons on the role of the institutional investors in promoting the good corporate governance may be listed as under:

\(^1\) [http://nseindia.com/content/research/Paper42.pdf](http://nseindia.com/content/research/Paper42.pdf) (Institutional Investors and Corporate Governance in India, by Pitabas Mohanty)
Based on the experience of countries where shareholders activism is vibrant, such as for example Australia, France, the UK, or the United States, it is reasonable to expect that Indian institutional investor should use their ownership rights more actively.

Findings of the World Bank suggests that Indian institutional investors seldom review the agenda of shareholders meetings, do not attend shareholders meetings, and do not exercise their voting rights, unless something goes drastically wrong, or if a takeover situation occurs. Nor do they disclose their voting records. Foreign institutional investors tend to exercise their ownership rights more actively.

**World Bank Recommendation**

**Policy Recommendation # 1:** Based on discussions with policy makers, market regulators and market participants, and taking into account the current topology of India's institutional investment community, a least cost, voluntary approach to compliance with OECD Principle 1.G seems most appropriate for India, at least for the next few years. Such an approach would introduce “soft” incentives for institutional investors to differentiate themselves from each other and leave market forces to drive the process. It is therefore recommended that the Securities and Exchange Board of India for mutual funds and FIIs, and the Insurance Regulatory and Development Authority for insurance companies, and the Pension Fund Regulatory and Development Authority for pension funds (when these are set up) issue some guidelines, on a stand alone basis or as part of their code of conduct as appropriate, recommending that the institutions that fall under their oversight, should disclose to the market, on a comply or explain basis, via their company website, their overall corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights. It should also be recommended that these institutions post annually on the same website, their voting records, on an ex-post basis.

**OECD Principles**

Institutional investors acting in a fiduciary capacity should disclose their overall corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights.

**ICSI Recommendation 23:** It should be mandatory for institutional investors to disclose as to how they manage material conflicts of interests that may affect the exercise of key ownership rights
regarding their investments. The disclosure should be made in the prospectuses and periodic financial statements of the mutual funds.

Over the last decade and a half, market forces have driven Indian financial services companies to seek critical mass. Large financial conglomerates have been created that include insurance companies, commercial banks, investment banks, non banks financial institutions, and mutual funds. Whilst this transformation has created vast synergies, and made the groups more competitive, it has also created potential conflicts of interests between a group's fiduciary institution and its other components.

**World Bank Recommendation**

Policy Recommendation 2: In line with international best practice, the Securities and Exchange Board of India for Mutual Funds and the Insurance Regulatory and Development Authority for Insurance Companies should mandate the disclosure by institutions under their oversights of how they manage material conflicts of interests that may affect the exercise of key ownership rights regarding their investments. More generally such disclosure should extend to all institutional investors acting in a fiduciary capacity. The disclosure should be made in the prospectuses and in the periodic financial statements.

**OECD Principles**

Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.

**ICSI Recommendation 24:** A directive be issued to clarify the nature of the information that can be exchanged at meetings between institutional investors and companies, in compliance with the Insider Trading Regulations of 1992 and its 2002 amendment. The directive should stress that it does not condone the selective disclosure of information by companies to institutions and clearly set the principle of equality of treatment of all shareholders by corporations.

**World Bank Recommendation**

SEBI should issue a directive to clarify the nature of the information that can be exchanged at meetings between institutional investors and companies, in compliance with the Insider Trading Regulations of 1992 and its 2002 amendment. The directive should stress that it does not condone the selective disclosure of information by companies to institutions and clearly set the principle of equality of treatment of all shareholders by corporations.

SEBI vide circular dated 24th March, 2014 had in order to improve transparency as well as encourage Mutual Funds/AMCs to diligently exercise their voting rights in best interest of the unit-holders, has been decided that:

1. **AMCs shall be required to record and disclose specific rationale supporting their voting decision (for, against or abstain) with respect to each vote proposal.**

2. **AMCs shall additionally be required to publish summary of the votes cast across all its investee company and its break-up in terms of total number of votes cast in favor, against or abstained from.**

3. **AMCs shall be required to make disclosure of votes cast on their website (in spreadsheet format) on a quarterly basis, within 10 working days from the end of the quarter. Further, AMCs shall continue disclosing voting details in their annual report.**

4. **Further, on an annual basis, AMCs shall be required to obtain Auditor's certification on the voting reports being disclosed by them.**
The UK Stewardship Code

The Stewardship Code is a part of UK company law concerning principles that institutional investors are expected to follow. It was released in 2010 by the Financial Reporting Council, and is directed at asset managers who hold voting rights on shares in United Kingdom companies. Its principal aim is to make institutional investors, who manage "other people's money", be active and engage in corporate governance in the interests of their beneficiaries (the shareholders).

The UK Stewardship Code traces its origins to 'The Responsibilities of Institutional Shareholders and Agents: Statement of Principles,' first published in 2002 by the Institutional Shareholders Committee (ISC), and which the ISC converted to a code in 2009. Following the 2009 Walker Review of governance in financial institutions, the FRC was invited to take responsibility for the Code. In 2010, the FRC published the first version of the UK Stewardship Code, which closely mirrored the ISC code. This edition of the Code does not change the spirit of the 2010 Code.

1. Stewardship aims to promote the long term success of companies in such a way that the ultimate providers of capital also flourish. Effective stewardship benefits companies, investors and the economy as a whole.

2. In publicly listed companies responsibility for stewardship is shared. The primary responsibility rests with the board of the company, which oversees the actions of its management. Investors in the company also play an important role in holding the board to account for the fulfillment of its responsibilities.

3. The UK Corporate Governance Code identifies the principles that underlie an effective board. The UK Stewardship Code sets out the principles of effective stewardship by investors. In so doing, the Code assists institutional investors better to exercise their stewardship responsibilities, which in turn gives force to the “comply or explain” system.

4. For investors, stewardship is more than just voting. Activities may include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration. Engagement is purposeful dialogue with companies on these matters as well as on issues that are the immediate subject of votes at general meetings.

5. Institutional investors’ activities include decision-making on matters such as allocating assets, awarding investment mandates, designing investment strategies, and buying or selling specific securities. The division of duties within and between institutions may span a spectrum, such that some may be considered asset owners and others asset managers.

6. Broadly speaking, asset owners include pension funds, insurance companies, investment trusts and other collective investment vehicles. As the providers of capital, they set the tone for stewardship and may influence behavioural changes that lead to better stewardship by asset managers and companies. Asset managers, with day-to-day responsibility for managing investments, are well positioned to influence companies’ long-term performance through stewardship.

7. Compliance with the Code does not constitute an invitation to manage the affairs of a company or preclude a decision to sell a holding, where this is considered in the best interest of clients or beneficiaries.
Seven Principles:

Principle 1- Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

Guidance

- Stewardship activities include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration.
- Engagement is purposeful dialogue with companies on those matters as well as on issues that are the immediate subject of votes at general meetings.
- The policy should disclose how the institutional investor applies stewardship with the aim of enhancing and protecting the value for the ultimate beneficiary or client.
- The statement should reflect the institutional investor’s activities within the investment chain, as well as the responsibilities that arise from those activities.
- In particular, the stewardship responsibilities of those whose primary activities are related to asset ownership may be different from those whose primary activities are related to asset management or other investment-related services.
- Where activities are outsourced, the statement should explain how this is compatible with the proper exercise of the institutional investor’s stewardship responsibilities and what steps the investor has taken to ensure that they are carried out in a manner consistent with the approach to stewardship set out in the statement.
- The disclosure should describe arrangements for integrating stewardship within the wider investment process.

Principle 2- Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.

Guidance

- An institutional investor’s duty is to act in the interests of its clients and/or beneficiaries.
- Conflicts of interest will inevitably arise from time to time, which may include when voting on matters affecting a parent company or client.
- Institutional investors should put in place, maintain and publicly disclose a policy for identifying and managing conflicts of interest with the aim of taking all reasonable steps to put the interests of their client or beneficiary first.
- The policy should also address how matters are handled when the interests of clients or beneficiaries diverge from each other.

Principle 3- Institutional investors should monitor their investee companies.

Guidance: Effective monitoring is an essential component of stewardship. It should take place regularly and be checked periodically for effectiveness.

- When monitoring companies, institutional investors should seek to: keep abreast of the company’s performance; - keep abreast of developments, both internal and external to the company, that drive the company’s value and risks; - satisfy themselves that the company’s leadership is effective - satisfy themselves that the company’s board and committees adhere to the spirit of the; - UK Corporate
Governance Code, including through meetings with the chairman and other board members; - consider the quality of the company’s reporting; and attend the General Meetings of companies in which they have a major holding, where appropriate and practicable.

- Institutional investors should consider carefully explanations given for departure from the UK Corporate Governance Code and make reasoned judgements in each case.
- They should give a timely explanation to the company, in writing where appropriate, and be prepared to enter a dialogue if they do not accept the company’s position.
- Institutional investors should endeavour to identify at an early stage issues that may result in a significant loss in investment value.
- If they have concerns, they should seek to ensure that the appropriate members of the investee company’s board or management are made aware.
- Institutional investors may or may not wish to be made insiders. An institutional investor who may be willing to become an insider should indicate in its stewardship statement the willingness to do so, and the mechanism by which this could be done.
- Institutional investors will expect investee companies and their advisers to ensure that information that could affect their ability to deal in the shares of the company concerned is not conveyed to them without their prior agreement.

Principle 4 - Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.

Guidance:

Institutional investors should set out the circumstances in which they will actively intervene and regularly assess the outcomes of doing so. Intervention should be considered regardless of whether an active or passive investment policy is followed. In addition, being underweight is not, of itself, a reason for not intervening. Instances when institutional investors may want to intervene include, but are not limited to, when they have concerns about the company’s strategy, performance, governance, remuneration or approach to risks, including those that may arise from social and environmental matters. Initial discussions should take place on a confidential basis. However, if companies do not respond constructively when institutional investors intervene, then institutional investors should consider whether to escalate their action, for example, by:

- holding additional meetings with management specifically to discuss concerns;
- expressing concerns through the company’s advisers;
- meeting with the chairman or other board members;
- intervening jointly with other institutions on particular issues;
- making a public statement in advance of General Meetings;
- submitting resolutions and speaking at General Meetings; and
- requisitioning a General Meeting, in some cases proposing to change board membership.

Principle 5 - Institutional investors should be willing to act collectively with other investors where appropriate.
Guidance:
At times collaboration with other investors may be the most effective manner in which to engage. Collective engagement may be most appropriate at times of significant corporate or wider economic stress, or when the risks posed threaten to destroy significant value.

Institutional investors should disclose their policy on collective engagement, which should indicate their readiness to work with other investors through formal and informal groups when this is necessary to achieve their objectives and ensure companies are aware of concerns. The disclosure should also indicate the kinds of circumstances in which the institutional investor would consider participating in collective engagement.

Principle 6 - Institutional investors should have a clear policy on voting and disclosure of voting activity.

Guidance:
Institutional investors should seek to vote all shares held. They should not automatically support the board. If they have been unable to reach a satisfactory outcome through active dialogue then they should register an abstention or vote against the resolution. In both instances, it is good practice to inform the company in advance of their intention and the reasons why.

Institutional investors should disclose publicly voting records. Institutional investors should disclose the use made, if any, of proxy voting or other voting advisory services. They should describe the scope of such services, identify the providers and disclose the extent to which they follow, rely upon or use recommendations made by such services. Institutional investors should disclose their approach to stock lending and recalling lent stock.

Principle 7 - Institutional investors should report periodically on their stewardship and voting activities.

Guidance:
Institutional investors should maintain a clear record of their stewardship activities. Asset managers should regularly account to their clients or beneficiaries as to how they have discharged their responsibilities. Such reports will be likely to comprise qualitative as well as quantitative information. The particular information reported and the format used, should be a matter for agreement between agents and their principals. Asset owners should report at least annually to those to whom they are accountable on their stewardship policy and its execution.

Transparency is an important feature of effective stewardship. Institutional investors should not, however, be expected to make disclosures that might be counterproductive. Confidentiality in specific situations may well be crucial to achieving a positive outcome.

Asset managers that sign up to this Code should obtain an independent opinion on their engagement and voting processes having regard to an international standard or a UK framework such as AAF 01/062. The existence of such assurance reporting should be publicly disclosed. If requested, clients should be provided access to such assurance reports.

Principles for Responsible Investment (PRI)

The United Nations-supported Principles for Responsible Investment (PRI) Initiative is an international network of investors working together to put the six Principles for Responsible Investment into practice. Its goal is to understand the implications of sustainability for investors and support signatories to incorporate these issues into their investment decision making and ownership practices.
In implementing the Principles, signatories contribute to the development of a more sustainable global financial system.

The Principles are voluntary and aspirational. They offer a menu of possible actions for incorporating ESG issues into investment practices across asset classes. Responsible investment is a process that must be tailored to fit each organisation’s investment strategy, approach and resources. The Principles are designed to be compatible with the investment styles of large, diversified, institutional investors that operate within a traditional fiduciary framework.

The PRI Initiative has quickly become the leading global network for investors to publicly demonstrate their commitment to responsible investment, to collaborate and learn with their peers about the financial and investment implications of ESG issues, and to incorporate these factors into their investment decision making and ownership practices.

If you have suggestions on the PRI work plan or strategy that you would like us to hear about, you can email them to suggestions@unpri.org. We will review your suggestions and respond accordingly.

We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; fostering good governance, integrity and accountability; and addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

The six Principles

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice.

The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

**Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.**

Possible actions:

- Address ESG issues in investment policy statements
- Support development of ESG-related tools, metrics, and analyses
- Assess the capabilities of internal investment managers to incorporate ESG issues
- Assess the capabilities of external investment managers to incorporate ESG issues
• Ask investment service providers (such as financial analysts, consultants, brokers, research firms, or rating companies) to integrate ESG factors into evolving research and analysis

• Encourage academic and other research on this theme

• Advocate ESG training for investment professionals

Principle 2: We will be active owners and incorporate ESG issues into ownership policies and practices.

Possible actions:

• Develop and disclose an active ownership policy consistent with the Principles

• Exercise voting rights or monitor compliance with voting policy (if outsourced)

• Participate in the development of policy, regulation, and standard setting (such as promoting and protecting shareholder rights)

• File shareholder resolutions consistent with long-term ESG considerations

• Engage with companies on ESG issues

• Participate in collaborative engagement initiatives

• Ask investment managers to undertake and report on ESG-related engagement

Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which they invest.

Possible actions:

• Ask for standardised reporting on ESG issues (using tools such as the Global Reporting Initiative)

• Ask for ESG issues to be integrated within annual financial reports

• Ask for information from companies regarding adoption or adherence to relevant norms, standards, codes of conduct or international initiatives (such as the UN Global Compact)

• Support shareholder initiatives and resolutions promoting ESG disclosure

Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.

Possible actions:

• Include Principles-related requirements in requests for proposals (RFPs)

• Align investment mandates, monitoring procedures, performance indicators and incentive structures accordingly (for example, ensure investment management processes reflect long-term time horizons when appropriate)

• Communicate ESG expectations to investment service providers

• Revisit relationships with service providers that fail to meet ESG expectations

• Support the development of tools for benchmarking ESG integration

• Support regulatory or policy developments that enable implementation of the Principles
Principle 5: We will work together to enhance effectiveness in implementing the Principles.

Possible actions:

- Support/participate in networks and information platforms to share tools, pool resources, and make use of investor reporting as a source of learning
- Collectively address relevant emerging issues
- Develop or support appropriate collaborative initiatives

Principle 6: We will each report on their activities and progress towards implementing the Principles.

Possible actions:

- Disclose how ESG issues are integrated within investment practices
- Disclose active ownership activities (voting, engagement, and/or policy dialogue)
- Disclose what is required from service providers in relation to the Principles
- Communicate with beneficiaries about ESG issues and the Principles
- Report on progress and/or achievements relating to the Principles using a ‘Comply or Explain* approach
- Seek to determine the impact of the Principles
- Make use of reporting to raise awareness among a broader group of stakeholders

* The Comply or Explain approach requires signatories to report on how they implement the Principles, or provide an explanation where they do not comply with them.

The Principles for Responsible Investment were developed by an international group of institutional investors reflecting the increasing relevance of environmental, social and corporate governance issues to investment practices. The process was convened by the United Nations Secretary-General.

In signing the Principles, we as investors publicly commit to adopt and implement them, where consistent with our fiduciary responsibilities. We also commit to evaluate the effectiveness and improve the content of the Principles over time. We believe this will improve our ability to meet commitments to beneficiaries as well as better align our investment activities with the broader interests of society.

We encourage other investors to adopt the Principles.

Code for Responsible Investing in South Africa (CRISA)

The Code for Responsible Investing in South Africa (CRISA) gives guidance on how the institutional investor should execute investment analysis and investment activities and exercise rights so as to promote sound governance.

CRISA applies to:

- Institutional investors as asset owners, for example, pension funds and insurance companies.
- Service providers of institutional investors, for example, asset and fund managers and consultants.

Introduction: A non-mandatory market-based code of governance, such as the King Code, is (in the context of listed companies) stronger if its implementation is overseen by those with a vested interest in effective market forces i.e. the institutional investor. The institutional investor has by virtue of its share ownership and
rights, including voting rights, the ability to influence and encourage investee companies to apply sound governance principles and practices. Recent experience in South Africa and internationally indicates that market failures in relation to governance are, at least in part, due to an absence of active institutional investors, or investment behaviour driven by short-term results.

In reaction to comments on the King Report which were submitted by the South African PRI network and which called for guidance to the investor community to be included in the Report, the King Committee recommended that a separate code be drafted to specifically set out the expectations from institutional investors in this regard. The Committee on Responsible Investing by Institutional Investors in South Africa has been convened by the IoDSA to develop such a code.

**Purpose:** The King Code was written from the perspective of the board of the company as the focal point of corporate governance. CRISA is intended to give guidance on how the institutional investor should execute investment analysis and investment activities and exercise rights so as to promote sound governance. Read together, the King Code and CRISA provide a framework that relates to the function of all role players in the overall governance system, including boards of companies, institutional shareholders, their service providers and the ultimate beneficiaries. The objective of providing such a framework is to ensure that sound governance is practised which results in better performing companies that deliver both economic value as well as value within its broader meaning.

**Application:** Legally, the institutional investor, who is the asset owner, has fiduciary duties towards the ultimate beneficiaries of these investments and is accountable in this regard. If an institutional investor appoints a service provider, to make investment decisions or to execute any aspect of the investment activities dealt within CRISA, that relationship is regulated by the mandate between the asset owner and service provider. Expectations for application of CRISA’s reporting requirements and sanctions for non-adherence by the service provider are to be agreed and determined via this mandate. However, the accountability of the institutional investor to the ultimate beneficiary is not diminished by such mandate. In addition, to the institutional investor, the pivotal role of service providers in promoting sound governance cannot be disregarded and it is intended that the principles and practice recommendations contained in CRISA also apply to service providers and the manner in which they execute their mandates. Therefore where CRISA makes recommendations that pertain to investment decisions or investment activities that fall within the ambit of the mandate, the service provider should follow such recommendations even if the recommendation makes reference to the institutional investor only. The approach that CRISA applies to both the institutional investor and its service providers, but that the institutional investor bears accountability to ultimate beneficiaries, has been followed throughout this document. As the purpose of CRISA is to form part of an effective governance framework in South Africa, it is furthermore proposed that foreign pension funds, insurance companies, investment trusts and other collective investment vehicles apply CRISA to the extent that they invest in South African companies. Institutional investors and service providers should adopt the principles and practice recommendations in CRISA on an “apply or explain” basis. Where there is conflict between CRISA and applicable legislation, the legislation will prevail. The effective date for reporting on the application of CRISA is 1 February 2012.

**Five Principles:** CRISA originally consisted of four principles. While the original four remain, a fifth principle addressing conflict of interest was added as a result of feedback by stakeholders on the draft Code.

**Principle 1:** An institutional investor should incorporate sustainability considerations, including ESG, into its investment analysis and investment activities as part of the delivery of superior risk-adjusted returns to the ultimate beneficiaries.
1. An institutional investor should develop a policy on how it incorporates sustainability considerations, including ESG, into its investment analysis and activities. The matters to be dealt with in the policy should include, but not necessarily be limited to, an assessment of: a. the sum of tangible and intangible assets of a company; b. the quality of the company's integrated reporting dealing with the long-term sustainability of the company's strategy and operations. If integrated reporting has not been applied, due enquiry should be made on the reasons for this; c. the manner in which the business of the company is being conducted based on, for example, alignment with targeted investment strategies of the institutional investor and the code of conduct and supply chain code of conduct of the company.

2. An institutional investor should ensure implementation of the policy on sustainability considerations, including ESG, and establish processes to monitor compliance with the policy.

**Principle 2:** An institutional investor should demonstrate its acceptance of ownership responsibilities in its investment arrangements and investment activities.

3. An institutional investor should develop a policy dealing with ownership responsibilities. The policy should include, but not necessarily be limited to the following: a. guidelines to be applied (e.g. King III) for the identification of sustainability concerns, including ESG, at a company. b. mechanisms of intervention and engagement with the company when concerns have been identified and the means of escalation of activities as a shareholder if these concerns cannot be resolved. c. voting at shareholder meetings, including the criteria that are used to reach voting decisions and for public disclosure of full voting records.

4. Even if passive investment strategies are followed, active voting policies incorporating sustainability considerations, including ESG, should still be followed.

5. An institutional investor should ensure implementation of the policy on ownership responsibilities and establish processes to monitor compliance with the policy.

6. Where the institutional investor outsources to third party service providers, the onus is on the institutional investor as owner to ensure that the mandate deals with sustainability concerns, including ESG, and that there are processes to oversee that the service providers apply the provisions of CRISA when executing their mandate.

7. The institutional investor should introduce controls that prevent it from receiving price sensitive information regarding a company or acting on such information in a manner that makes it an ‘insider’ in terms of the Securities Services Act No 36 of 2004. These controls should be applied when engaging with the company, and when seeking any information it requires, whether this is to fulfil its duties or to act within the guidelines of CRISA.

**Principle 3:** Where appropriate, institutional investors should consider a collaborative approach to promote acceptance and implementation of the principles of CRISA and other codes and standards applicable to institutional investors.

8. An institutional investor should consider a collaborative approach to work jointly with other shareholders, service providers, regulators, investee companies and ultimate beneficiaries to, where appropriate, promote acceptance and implementation of CRISA and sound governance. Parties should be aware of the consequences of acting in concert in terms of applicable legislation.

**Principle 4:** An institutional investor should recognise the circumstances and relationships that hold a potential for conflicts of interest and should pro-actively manage these when they occur.
9. All of the circumstances and relationships that could potentially lead to a conflict of interest should be identified by the institutional investor and a policy for preventing and managing these conflicts should be developed.

10. An institutional investor should ensure implementation of the policy on prevention and management of conflicts of interests and establish processes to monitor compliance with this policy.

**Principle 5:** Institutional investors should be transparent about the content of their policies, how the policies are implemented and how CRISA is applied to enable stakeholders to make informed assessments.

11. An institutional investor should regularly engage with its stakeholder groupings, including investee companies and the ultimate beneficiaries, in order to, inter alia, identify and understand information requirements and, at least once a year, fully and publicly disclose to what extent it applies to CRISA.

12. If an institutional investor does not apply some or any of the principles or recommendations in CRISA or applies them differently from how they are set out, it should in a transparent manner explain the reasons for this and the alternative measures employed.

13. The disclosure by institutional investors should be made public in order that it is readily accessible by all stakeholders, including investee companies and the ultimate beneficiaries.

14. The following policies should be disclosed publicly upon CRISA becoming effective and subsequently in the event of changes to the policies: a. policy on incorporation of sustainability considerations, including ESG, into investment analysis and investment activities with reference to the matters as set out under Principle 1. b. policy in regard to ownership responsibilities, including voting as set out under Principle 2. c. policy on identification, prevention and management of conflicts of interests as set out under Principle 4.

15. Non-disclosure of voting records by an institutional investor and its service providers precludes the investee company the opportunity to engage with the institutional investor or its service providers regarding the vote exercised. Therefore an institutional investor and its service providers should, before agreeing to a proxy or other instruction to keep voting records confidential, carefully consider the reasons put forward to justify confidentiality.

16. Disclosure of policies should be reinforced by clear explanation of how the commitments made in the policies were practically implemented and monitored during the reporting period.

17. There should be disclosure by an institutional investor of processes to ensure that its service providers apply CRISA as well as the requirements of the institutional investor’s policies.

**California Public Employees’ Retirement System (Updated March 16, 2015)**

The California Public Employees’ Retirement System (CalPERS, System) is the largest U.S. public pension fund, with assets totaling approximately $300 billion spanning domestic and international markets as of June 30, 2014. Its mission is to provide responsible and efficient stewardship of the System to deliver promised retirement and health benefits, while promoting wellness and retirement security for members and beneficiaries. This mission was adopted by the CalPERS Board of Administration in serving more than 1.6 million members and retirees.

The CalPERS Board of Administration is guided by the CalPERS Board’s Investment Committee, Investment Beliefs1 and Core Values: Quality, Respect, Accountability, Integrity, Openness, and Balance. CalPERS management and more than 380 Investment Office staff carry out the daily activities of the investment program. Our goal is to efficiently and effectively manage investments to achieve the
highest possible return at an acceptable level of risk. In doing so, CalPERS has generated strong long-term returns.

CalPERS Global Governance Program has evolved since the mid-80’s when it was solely reactionary: reacting to the anti-takeover actions of corporate managers that struck a dissonant chord with owners of the corporate entity concerned with accountability and fair play. The late 1980s and early 1990s represented a period in which CalPERS learned a great deal about the “rules of the game” – how to influence corporate managers, what issues were likely to elicit fellow shareowner support, and where the traditional modes of shareowner/corporation communication were at odds with current reality. Beginning in 1993, CalPERS turned its focus toward companies considered by virtually every measure to be “poor” financial performers. By centering its attention and resources in this way, CalPERS could demonstrate very specific and tangible results to those who questioned the value of corporate governance.

In 2011, CalPERS Global Governance Program transitioned into an Investment Office-wide role to support the Total Fund; and, the CalPERS Board approved the adoption of a Total Fund process for integrating environmental, social, and governance (ESG) issues across the investment portfolio as a strategic priority. This transition recognizes CalPERS’ ongoing effort3 to integrate ESG factors into investment decision making across asset classes, grounded in the three forms of economic capital – financial, human, and physical – that are needed for long-term value creation. This work has also been integrated into CalPERS Investment Beliefs which address sustainable investment, risk management, and CalPERS engagement with companies, regulators, managers, and stakeholders.

The CalPERS Board, through its Investment Committee, has adopted the Global Governance Principles (Global Principles). The Global Principles create the framework by which CalPERS:

1. Executes its shareowner proxy voting responsibilities.
2. Engages investee companies to achieve long-term sustainable risk-adjusted returns.
3. Requests internal and external managers of CalPERS capital to take into consideration when making investment decisions.

The Global Principles are broken down into three areas – Core, Domestic, and International Principles. Adopting the Global Principles in its entirety may not be appropriate for every company in the global capital marketplace due to differing developmental stages, competitive environment, regulatory or legal constraints. However, CalPERS does believe the criteria contained in the Core Principles should be adopted by companies across all markets - from developed to emerging – in order to establish the foundation for achieving long-term sustainable investment returns through accountable corporate governance structures.

For companies in the United States or listed on U.S. stock exchanges, CalPERS advocates the expansion of the Core Principles into the Domestic Principles. For companies outside the United States or listed on non-U.S. stock exchanges, CalPERS advocates the expansion of the Core Principles into the International Principles.

CalPERS expects all internal and external managers of CalPERS capital to integrate the Global Principles into investment decision making including proxy voting, consistent with fiduciary duty. CalPERS recognizes that countries and companies are in different developmental stages and that CalPERS investment managers will need to exercise their best judgment after taking all relevant factors, principles, and trends into account. CalPERS requires internal and external managers across the total fund to consider these Global Principles among the decision factors employed in the investment process.
Principles:

There are many features that are important considerations in the continuing evolution of corporate governance best practices. However, the underlying tenet for CalPERS Core Principles is that fully accountable governance structures produce, over the long term, the best returns to shareowners. CalPERS believes the following Core Principles should be adopted by companies and markets – from developed to emerging – in order to establish the foundation for achieving long-term sustainable investment returns through accountable corporate governance structures.

1. Sustainability: Companies and external managers in which CalPERS invests are expected to optimize operating performance, profitability and investment returns in a risk-aware manner while conducting themselves with propriety and with a view toward responsible conduct. Anchored by CalPERS Investment Beliefs, CalPERS believes long-term value creation requires the effective management of three forms of capital described as follows:

   a. **Financial Capital (Governance):** Governance is the primary tool to align interests between CalPERS and the managers of our financial capital – including companies and external managers. Good governance enhances a company’s long-term value and protects investor interests.

   b. **Physical Capital (Environment):** Encouraging external managers, portfolio companies, and policy makers to engage in responsible environmental practices is important to identifying opportunities and risk management. This means making wise use of scarce resources, considering impact, and addressing systemic risks, such as climate change.

   c. **Human Capital (Social):** The success and long-term value of the companies we invest in will be impacted by their management of human capital. This includes fair labor practices, responsible contracting, workplace and board diversity, and protecting the safety of employees directly and through the supply chain.

2. Director Accountability: Directors should be accountable to shareowners, and management accountable to directors. To ensure this accountability, directors must be accessible to shareowner inquiry concerning their key decisions affecting the company’s strategic direction.

3. Transparency: Operating, financial, and governance information about companies must be readily transparent to permit accurate market comparisons; this includes disclosure and transparency of objective globally accepted minimum accounting standards, such as the International Financial Reporting Standards (“IFRS”).

4. One-share/One-vote: All investors must be treated equitably and upon the principle of one-share/one-vote.

5. Proxy Materials: Proxy materials should be written in a manner designed to provide shareowners with the information necessary to make informed voting decisions. Similarly, proxy materials should be distributed in a manner designed to encourage shareowner participation. All shareowner votes, whether cast in person or by proxy, should be formally counted with vote outcomes formally announced.

6. Code of Best Practices: Each capital market in which shares are issued and traded should adopt its own Code of Best Practices to promote transparency of information, prevention of harmful labor practices, investor protection, and corporate social responsibility. Where such a code is adopted, companies should disclose to their shareowners whether they are in compliance.

7. Long-term Vision: Corporate directors and management should have a long-term strategic vision that, at
its core, emphasizes sustained shareowner value and effective management of both risk and opportunities in the oversight of financial, physical, and human capital. In turn, despite differing investment strategies and tactics, shareowners should encourage corporate management to resist short-term behavior by supporting and rewarding long-term superior returns.

8. Access to Director Nominations: Shareowners should have effective access to the director nomination process.

9. Political Stability: Progress toward the development of basic democratic institutions and principles, including such things as: a strong and impartial legal system; and, respect and enforcement of property and shareowner rights.

**Political stability encompasses:**

a. Political risk: internal and external conflict; corruption; the military and religion in politics; law and order; ethnic tensions; democratic accountability; bureaucratic quality.

b. Civil liberties: freedom of expression, association and organization rights; rule of law and human rights; free trade unions and effective collective bargaining; personal autonomy and economic rights.

c. Independent judiciary and legal protection: an absence of irregular payments made to the judiciary; the extent to which there is a trusted legal framework that honors contracts, clearly delineates ownership and protects financial assets.

10. Transparency: Financial transparency, including elements of a free press, is necessary for investors to have truthful, accurate and relevant information.

**Transparency encompasses:**

a. Freedom of the press: structure of the news delivery system in a country; laws and their promulgation with respect to the influence of the news; the degree of political influence and control; economic influences on the news; the degree to which there are violations against the media with respect to physical violations and censorship.

b. Monetary and fiscal transparency: the extent to which governmental monetary and fiscal policies and implementation are publicly available in a clear and timely manner, in accordance with international standards.

c. Stock exchange listing requirements: stringency of stock exchange listing requirements with respect to frequency of financial reporting, the requirement of annual independent audits, and minimal financial viability.

d. Accounting standards: the extent to which U.S. Generally Accepted Accounting Principles, or International Accounting Standards is used in financial reporting; whether the country is a member of the International Accounting Standards Council.

11. Productive Labor Practices: No harmful labor practices or use of child labor. In compliance, or moving toward compliance, with the International Labor Organization (ILO) Declaration on the Fundamental Principles and Rights at Work.

**Productive Labor Practices encompasses:**

a. ILO ratification: whether the convention is ratified, not ratified, pending ratification or denounced.

b. Quality of enabling legislation: the extent to which the rights described in the ILO convention are
protected by law.

c. Institutional capacity: the extent to which governmental administrative bodies with labor law
   enforcement responsibility exist at the national, regional and local level.

d. Effectiveness of implementation: evidence that enforcement procedures exist and are working
   effectively; evidence of a clear grievance process that is utilized and provides penalties that have
deterrence value.

12. Corporate Social Responsibility – Eliminating Human Rights Violations: Corporations should adopt
maximum progressive practices toward the elimination of human rights violations in all countries or
environments in which the company operates. Additionally, these practices should emphasize and focus on
preventing discrimination and/or violence based on race, color, religion, national origin, age, disability, sexual
orientation, gender identity, marital status, or any other status protected by laws or regulations in areas of a
company’s operation.

Companies should operate in compliance, or moving toward compliance, with the Global Sullivan Principles
(Appendix B), or the human rights and labor standards principles exemplified by the United Nations Global
Compact Principles.

are adequately rewarded.

   Market regulation and liquidity encompasses:
   a. Market capitalization
   b. Change in market capitalization
   c. Average monthly trading volume
   d. Growth in listed securities
   e. Market volatility as measured by standard deviation
   f. Return/risk ratio

14. Capital Market Openness: Free market policies, openness to foreign investors, and legal protection for
foreign investors.

   Capital market openness encompasses:
   a. Foreign investment: degree to which there are restrictions on foreign ownership of local assets,
      repatriation restrictions or un-equal treatment of foreigners and locals under the law.
   b. Trade policy: degree to which there are deterrents to free trade such as trade barriers and punitive
tariffs.
   c. Banking and finance: degree of government ownership of banks and allocation of credit; freedom
financial institutions have to offer all types of financial services; protectionist banking regulations
against foreigners.

15. Settlement Proficiency/Transaction Costs: Reasonable trading and settlement proficiency and
reasonable transaction costs.

   Settlement proficiency/transaction costs encompass:
a. Trading and settlement proficiency: degree to which a country’s trading and settlement is automated; success of the market in settling transactions in a timely, efficient manner.

b. Transaction costs: the costs associated with trading in a particular market, including stamp taxes and duties; amount of dividends and income taxes; capital gains taxes.

16. Disclosure: Companies should adopt corporate reporting guidelines in order to measure, disclose, and be accountable to internal and external stakeholders for organizational performance. Disclosure reporting guidelines should include:

a. The effect of environmental, social and governance impacts, risks and opportunities related to the company’s stakeholders.

b. Activities the company is undertaking to protect shareowner rights and investment capital.

17. Financial Markets: Policy makers and standards setters which impact investment portfolio risk and return should promote fair, orderly, and effectively regulated financial markets through the following:

a. Transparency: To promote full disclosure so that the financial markets provide incentives that price risk and opportunity.

b. Governance: To foster alignment of interest, protect investor rights and independence of regulators.

c. Systemic Risk: For earlier identification by regulators of issues that give rise to overall market risk that threaten global markets and foster action that mitigates those risks.

TOOLS USED BY INSTITUTIONAL INVESTORS

The Institutional Investors use different tools to assess the health of Company before investing resources in it. Some of the important tools are discussed as under:

One-to-one meetings: The meetings between institutional investors and companies are extremely important as a means of communication between the two parties. This is one clear example of the way that individual investors are at a disadvantage to institutional investors as corporate management will usually only arrange such meetings with large investors who are overwhelmingly institutional investors. A company will usually arrange to meet with its largest institutional investors on a one-to-one basis during the course of the year.

Voting: The right to vote which is attached to voting shares (as opposed to non-voting shares) is a basic prerogative of share ownership, and is particularly important given the division of ownership (shareholders) and control (directors) in the modern corporation. The right to vote can be seen as fundamental tools for some element of control by shareholders. The institutional investors can register their views by postal voting, or, vote electronically where this facility is available. Most of the large institutional investors now have a policy of trying to vote on all issues which may be raised at their investee company’s AGM. Some may vote directly on all resolutions, others may appoint a proxy (which may be a board member). Generally, an institutional investor will try to sort out any contentious issues with management ‘behind the scenes’, however if this fails, then they may abstain from voting on a particular issue (rather than voting with incumbent management as they generally would) or they may actually vote against a resolution. In this case, they would generally inform the firm of their intention to vote against. Corporate governance issues tend to be the most contentious, particularly directors’ remuneration and lengths of contract.

Focus lists: A number of institutional investors have established ‘focus lists’ whereby they target underperforming companies and include them on a list of companies which have underperformed a main index, such as Standard and Poor’s. Under performing index would be a first point of identification, other
factors would include not responding appropriately to the institutional investor’s inquiries regarding underperformance, and not taking account of the institutional investor’s views. After being put on the focus list, the companies often receive unwanted, attention of the institutional investors who may seek to change various directors on the board.

**Corporate governance rating systems:** With the increasing emphasis on corporate governance across the globe, it is perhaps not surprising that a number of corporate governance rating systems have been developed. Examples of such firms which have developed corporate governance rating systems are Deminor, Standard and Poor’s, and Governance Metrics International (GMI). The rating system cover several markets, for example, Deminor has tended to concentrate on European companies whilst Standard and Poor’s have used their corporate governance rating system in quite different markets, for example, Russia. GMI ratings cover a range of countries including the US, various countries in the Asia-Pacific region and Europe. These corporate governance rating systems should be of benefit to investors, both potential and those presently invested, and to the companies themselves.

In turn, the ratings will also be useful to governments in identifying perceived levels of corporate governance in their country compared to other countries in their region, or outside it, whose companies may be competing for limited foreign investment. In emerging market countries in particular, those companies with a corporate governance infrastructure will, ceteris paribus, be less subject to cronyism and its attendant effects on corporate wealth. These companies would tend to be more transparent and accountable, and hence more attractive to foreign investors.

A corporate governance rating could be a powerful indicator of the extent to which a company currently is adding, or has the potential to add in the future, shareholder value. This is because a company with good corporate governance is generally perceived as more attractive to investors than one without. Good corporate governance should, for example, indicate a board that is prepared to participate actively in dialogue with its shareholders, ensuring the effective exercise of voice (Hirschman 1970) thus enabling investors to articulate their interests.

**CONCLUSION**

Shareholders are one of the most important stakeholders of a corporate. Upholding the legitimate rights of the shareholders, equitable treatment amongst all shareholders, meaningful engagement with them, etc. are all paramount in ensuring good corporate governance. Protection of shareholder rights is the fundamental expectation from any corporate.

**GLOSSARY OF TECHNICAL WORDS**

- **Class Action Suits**: Such number of member or members, depositor or depositors or any class of them, as the case may be, as are indicated in sub-section (2) may, if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors, file an application before the Tribunal on behalf of the members or depositors for seeking all or any of the following orders.

- **Minority Shareholders**: Shareholders who do not exert control over the board of directors of the companies, even if together they own the majority of shares.

- **SCORES**: SEBI has set up a separate cell to address the grievances of investors - SEBI Complaints Redressal System.

- **Sustainability**: *Sustainability* is the ability to continue a defined behavior indefinitely.
• **IEPF:** Investor Education and Protection Fund (IEPF) is for promotion of investors’ awareness and protection of the interests of investors. This website is an information providing platform to promote awareness, and it does not offer any investment advice or evaluation.

### LESSONS ROUND UP

- Protection of shareholder rights is sacrosanct for good corporate governance. It is one of the pillars of corporate governance.

- In India, the SEBI Act, 1992, the various SEBI Regulations/Guidelines and the Companies Act, 2013 enables the empowerment of shareholder rights.

- Any member of a company who complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members may apply to the Tribunal for an order.

- Shareholder has right to pass a special resolution, resolving that the company be wound up by the Tribunal.

- Principle III of the OECD Principles on Corporate Governance states that the corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders.

- Investor Education and Protection Fund (IEPF) has been established under Section 125 of the Companies Act, 2013 for promotion of investors’ awareness and protection of the interests of investors.

- The audit committee has an important role in monitoring related party transactions. In most jurisdictions the first level monitoring of the related party transactions is done by the audit committee.

- Independent judgment is critical to monitoring related party transactions and to ensure that agreed transactions are in the interests of the company and all shareholders.

- The Company shall disclose in its Corporate Governance Report, about the whistle Blower policy and affirmation that no personnel has been denied access to the audit committee.

- Shareholder activism refers to the active involvement of stockholders in their organization. Shareholders can ensure that the company follows good corporate governance practices and implements beneficial policies.

- Investor Relations (IR) is a strategic management responsibility that integrates finance, communication, marketing and securities law compliance to enable the most effective two-way communication between a company, the financial community, and other constituencies, which ultimately contributes to a company’s securities achieving fair valuation.

- The Sarbanes-Oxley Act significantly increased the importance of investor relations in the financial markets.

- Institutional investors are organizations which pool large sums of money and invest those sums in companies. Their role in the economy is to act as highly specialized investors on behalf of others.

- UK Stewardship Code (2012) aims to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities.

- As a strategy CalPERS invest in sick and ailing companies where it employs good governance practices to improvise company’s overall performance.

- The Institutional Investors use different tools like One-to-one meetings, focus lists, Corporate governance rating systems, etc. to assess the health of Company before investing resources in it.
REFERENCE FOR FURTHER READING


https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Discuss about the challenges in exercising shareholder rights?
2. What are the tools that an institutional investor can use to assess the health of a company?
3. Discuss the major principles of UK Stewardship code?
4. Who is insider? What is meant by insider trading?
5. What do you understand by shareholder activism?
Lesson 7
Corporate Governance and Other Stakeholders

LESSON OUTLINE

- Introduction
- Definition and Evolution of Stakeholder Theory
- Recognition of Stakeholder Concept in Law
- Stakeholder Engagement
- Stakeholder Analysis
- Better Stakeholder Engagement ensures Good Governance
- Types of Stakeholders
- The Caux Round Table
- The Clarkson Principles of Stakeholder Management
- Governance Paradigm and various Stakeholders
- Dealing with investor association, proxy advisory firm and institutional investors
- Conclusion
- Glossary
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

The objective of the study lesson is to enable the students to understand the changed concept from shareholder to the stakeholder.

It also provides link between good corporate governance and importance of various stakeholders in the governance structure of an organization.

The study discuss the Stakeholders Concept which is well recognized by the law and highlights the important government/regulatory initiative to channelize the corporate sector growth as well as ensuring good governance for the benefits of society at large. The study discuss about the role of employees, customer, lenders, vendors, government and society in ensuring good corporate governance in the corporate sector.

This chapter may be useful in performing the advisory role in practical areas of work.
INTRODUCTION

We may not know in how many organisations, we are the stakeholders, but yes, we are associated with these, in either way, direct or indirect. Today every one (apart from the shareholder / investors) whether it be as an employees of the organisation, supplier, customer, competitor, community, regulator, government all are having some sort of stake in the organisation. All such persons/ entities are associated with progress of business These groups are influenced by business and also have the ability to affect business.

“Stakeholder Theory is an idea about how business really works. It says that for any business to be successful it has to create value for customers, suppliers, employees, communities and financiers, shareholders, banks and others people with the money. It says that you can't look at any one of their stakes or stakeholders if you like, in isolation. Their interest has to go together, and the job of a manager or entrepreneur is to work out how the interest of customers, suppliers, communities, employees and financiers go in the same direction.

• Now, think about how important each of these groups is for business to be successful, think about a business that's lost its edge with its customers that has products and services that its customers don't want as much or that they don't want at all that's a business in decline.

• Think about a business who manages suppliers in a way that the suppliers don't make them better. The suppliers just take orders and sell stuff, but the suppliers aren't trying to make a business more innovative, more creative that's a business that's in a holding pattern and probably in decline.

• Think about a business whose employees don't want to be there every day who aren't using a hundred percent of their efforts and they're energy and their creativity to make the business better that's a business in decline.

• Think about a business that's not a good citizen in the community that routinely ignores or violates local custom in law. That doesn't pay attention to the quality of life in the community, doesn't pay attention to issues of corporate responsibility of sustainability, of its effects uncivil society that's a business that soon to be regulated into decline.

• Think about a business that doesn't create value doesn't create profits for its financiers, its shareholders, banks and others, that's a business in decline

So stakeholder theory is the idea that each one of these groups is important to the success of a business, and figuring out where their interests go in the same direction is what the managerial task and the entrepreneurial task is all about. Stakeholder theory says if you’re just focused on financiers you miss what makes capitalism tick. What makes capitalism tick is that shareholders and financiers, customers, suppliers, employees, communities can together create something that no one of them can create alone.

DEFINITION AND EVOLUTION OF STAKEHOLDER THEORY

In a business context, customers, investors, shareholders, employees, suppliers, government agencies, communities and many others who have a ‘stake’ or claim in some aspect of a company’s products, operations, markets, industry and outcomes are known as stakeholders.

Stakeholder theory suggests that the purpose of a business is to create as much value as possible for stakeholders. In order to succeed and be sustainable over time, executives must keep the interests of customers, suppliers, employees, communities and shareholders aligned and going in the same direction.
Innovation to keep these interests aligned is more important than the easy strategy of trading off the interests of stakeholders against each other. Hence, by managing for stakeholders, executives will also create as much value as possible for shareholders and other financiers.

A conceptual framework of business ethics and organizational management which addresses moral and ethical values in the management of a business or other organization. The stakeholder theory was first proposed in the book Strategic Management: A Stakeholder Approach by R. Edward Freeman and outlines how management can satisfy the interests of stakeholders in a business.

R. Edward Freeman’s view on Stakeholder Theory: One very broad definition of a stakeholder is any group or individual which can affect or is affected by an organization.” Such a broad conception would include suppliers, customers, stockholders, employees, the media, political action groups, communities, and governments. A more narrow view of stakeholder would include employees, suppliers, customers, financial institutions, and local communities where the corporation does its business. But in either case, the claims on corporate conscience are considerably greater than the imperatives of maximizing financial return to stockholders.

Stakeholder theories have grown in number and type since the term stakeholder was first coined in 1963. According to R. Edward Freeman1, whose work in stakeholder theory is well known, the stakeholder concept was originally defined as including “those groups without whose support the organization would cease to exist.” As a part of management theory and practice, stakeholder theory takes a number of forms. Descriptively, some research on stakeholder theory assumes that managers who wish to maximize their firm’s potential will take broader stakeholder interests into account. This gives rise to a number of studies on how managers, firms, and stakeholders do in fact interact. Normatively, other management studies and theories will discuss how corporations ought to interact with various stakeholders.

From an analytical perspective, a stakeholder approach can assist managers by promoting analysis of how the company fits into its larger environment, how its standard operating procedures affect stakeholders within the company (employees, managers, stockholders) and immediately beyond the company (customers, suppliers, financiers).

Freeman suggests, for example, that each firm should fill in a "generic stakeholder map" with specific stakeholders. General categories such as owners, financial community, activist groups, suppliers, government, political groups, customers, unions, employees, trade associations, and competitors would be filled in with more specific stakeholders. In turn, the rational manager would not make major decisions for the organization without considering the impact on each of these specific stakeholders. As the organization changes over time, and as the issues for decision change, the specific stakeholder map will vary.

Again, the contrast with Friedman's view [Milton Friedman(1912) believed that the only social responsibility of corporations is to provide a profit for its owners] should be evident: if the corporate manager looks only to maximize stockholder wealth, other corporate constituencies (stakeholders) can easily be overlooked.

In a normative sense, stakeholder theory strongly suggests that overlooking these other stakeholders is (a) unwise or imprudent and/or (b) ethically unjustified. To this extent, stakeholder theory participates in a broader debate about business and ethics: will an ethical company be more profitable in the long run than a company that looks only to the "bottom line" in any given quarter or year? Those who claim that corporate managers are imprudent or unwise in ignoring various non-stockholder constituencies would answer "yes." Others would claim that overlooking these other constituencies is not ethically justified, regardless of either

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1 R. Edward Freeman is a professor at the Darden School of the University of Virginia. He is the author of several books on Stakeholder Management including the influential Strategic Management: A Stakeholder Approach.
the short-term or long-term results for the corporation.

Inevitably, fundamental questions are raised, such as “What is a corporation, and what is the purpose of a corporation?” Many stakeholder theorists visualize the corporation not as a truly separate entity, but as part of a much larger social enterprise. The corporation is not so much a "natural" individual, in this view, but is rather constructed legally and politically as an entity that creates social goods.

A Stakeholder model of Company

RECOGNITION OF STAKEHOLDER CONCEPT IN LAW (UK & INDIA)

Under the UK Companies Act, 2006:

Section 172: Duty to promote the success of the company

1. A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to——

(a) the likely consequences of any decision in the long term,

(b) the interests of the company’s employees,

(c) the need to foster the company’s business relationships with suppliers, customers and others,

(d) the impact of the company’s operations on the community and the environment,

(e) the desirability of the company maintaining a reputation for high standards of business conduct, and

(f) the need to act fairly as between members of the company.

2. Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of
the company for the benefit of its members were to achieving those purposes.

3. The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

Under the Indian Companies Act, 2013

(a) Section 135 Corporate Social Responsibilities:

Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.

Section 166(2) Duties of the Directors: 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.

(b) Role and Functions of Independent Directors - Part II of Schedule IV Code of Independent Directors

With reference to the stakeholders’ interest, the role and functions of Independent Directors as specified in Part II of Schedule IV mentions that the independent directors shall safeguard the interests of all stakeholders, particularly the minority shareholders and balance the conflicting interest of the stakeholders.

Under the Principles articulated under SEBI (LODR) Regulations, 2015:

The listed entity should recognise the rights of stakeholders and encourage co-operation between listed entity and the stakeholders in the following manner:-

(i) The listed entity should respect the rights of stakeholders that are established by law or through mutual agreements.

(ii) Stakeholders should have the opportunity to obtain effective redress for violation of their rights.

(iii) Stakeholders should have access to relevant, sufficient and reliable information on a timely and regular basis to enable them to participate in Corporate Governance process.

(iv) The listed entity should devise an effective whistle blower mechanism enabling stakeholders, including individual employees and their representative bodies, to freely communicate their concerns about illegal or unethical practices.

STAKEHOLDER ENGAGEMENT

Stakeholder engagement is the process by which an organisation involves people who may be affected by the decisions it makes or can influence the implementation of its decisions. It is an alliance-building tool. Corporations practice stakeholder engagement in an effort to understand the needs of their stakeholders, create partnerships and to promote dialogue. Stakeholder engagement identifies stakeholders, assesses stakeholder needs, develops stakeholder relations plans and forms alliances with stakeholders.

Stakeholder engagement leads to increased transparency, responsiveness, compliance, organizational learning, quality management, accountability and sustainability. Stakeholder engagement is a central feature of sustainability performance. Stakeholder engagement is undertaken for numerous reasons which include:

- Improved corporate responsibility and financial performance across the globe.
To avoid conflict through negotiation, mediation and collaborative learning.

Development of a shared vision to direct future business decisions and operations.

To innovate through collaboration.

**Stakeholder engagement involves following steps:**

1. Identify stakeholder
2. Establish the goals and objectives of the company for engagement.
3. Identify stakeholder needs and interests.
4. Determine the stakeholder engagement strategy.
5. Evaluate outcome and internalize learnings.

Corporations are often confronted with the difficulty of balancing competing or opposing stakeholder needs or demands. The success of stakeholder engagement is initially dependent upon the quality of stakeholder analysis.

**Key principles of Stakeholder engagement**

- Communicate: Interactions from the various stakeholders should be promoted. Example: for customers there should be dedicated customer care center. The communication may be made through the print media elaborating about the progress of the company, which is also a part of the transparency and disclosure. Ensure intended message is understood and the desired response achieved.

- Consult, early and often: Always ask the right questions to get the useful information and ideas. To engage their support ask them for advice and listen how they feel.

- Remember, they are human: Operate with an awareness of human feelings.

- Plan it: Time investment and careful planning against it, has a significant payoff.

- Relationship: Try to engender trust with the stakeholders. Seek out networking opportunity.

- Simple but not easy: Show your care. Be empathetic. Listen to the stakeholders.

- Managing risk: Stakeholders can be treated as risk and opportunities that have probabilities and impact.

- Compromise: Compromise across a set of stakeholders’ diverging priorities.

- Understand what success is: Explore the value of the project to the stakeholder.

- Take responsibility: Project governance is the key of project success. It's always the responsibility of everyone to maintain an ongoing dialogue with stakeholders.

**Benefits:** Stakeholder engagement provides opportunities to further align business practices with societal needs and expectations, helping to drive long-term sustainability and shareholder value. Stakeholder engagement is intended to help the practitioners fully realise the benefits of stakeholder engagement in their organization, to compete in an increasingly complex and ever-changing business environment, while at the same time bringing about systemic change towards sustainable development.

**STAKEHOLDER ANALYSIS**

Stakeholder analysis is the identification of a project's/activity's key stakeholders, an assessment of their interests, and the ways in which these interests affect project riskiness and viability. It is linked to both
institutional appraisal and social analysis: drawing on the information deriving from these approaches, but also contributing to the combining of such data in a single framework. Stakeholder analysis contributes to project design/activity design through the logical framework, and by helping to identify appropriate forms of stakeholder participation. It is the process of identifying the individuals or groups that are likely to affect or be affected by a proposed action, and sorting them according to their impact on the action and the impact the action will have on them. This information is used to assess how the interests of those stakeholders should be addressed in a project plan, policy, program, or other action.

Stakeholder analysis is a key part of stakeholder management. A stakeholder analysis of an issue consists of weighing and balancing all of the competing demands on a firm by each of those who have a claim on it, in order to arrive at the firm's obligation in a particular case. A stakeholder analysis does not preclude the interests of the stakeholders overriding the interests of the other stakeholders affected, but it ensures that all affected will be considered.

Doing a stakeholder analysis can:

- draw out the interests of stakeholders in relation to the problems which the project is seeking to address (at the identification stage) or the purpose of the project (once it has started)
- identify conflicts of interests between stakeholders
- help to identify relations between stakeholders which can be built upon, and may enable establish synergies
- help to assess the appropriate type of participation by different stakeholders.

The underlining factor in the stakeholder concept is that every activity of an organization should be based taking into account the interests of all the stakeholders. A holistic approach ensuring fairness to all the stakeholders is completely necessary for the sustainability of an enterprise.

A major reason for increasing adoption of a Stakeholder Concept in setting business objectives is the recognition that businesses are affected by the "environment" in which they operate. Businesses come into regular contact with customers, suppliers, government agencies, families of employees, special interest groups. Decisions made by a business are likely to affect one or more of these "stakeholder groups".

The stakeholder concept suggests that the managers of a business should take into account their responsibilities to other groups – "not just the shareholder group" - when making decisions. The concept suggests that businesses can benefit significantly from cooperating with stakeholder groups, incorporating their needs in the decision-making process.

Stakeholder analysis helps with the identification of Stakeholders' interests, Mechanisms to influence other stakeholders, Potential risks, Key people to be informed about the project during the execution phase and Negative stakeholders as well as their adverse effects on the project.

**BETTER STAKEHOLDER ENGAGEMENT ENSURES GOOD GOVERNANCE**

Stakeholders are characterized by their relationship to the company and their needs, interests and concerns, which will be foremost in their minds at the start of an engagement process. However, as the process unfolds they will soon take a particular role with related tasks and responsibilities. The following are just some of the different roles that stakeholders can play:

- Experts, such as academics, who have been invited to contribute knowledge and strategic advice to the
company's board;

- Technical advisors with expertise on the social and environmental risks associated with particular technological and scientific developments invited to sit on scientific and ethical panels in science-based industries;

- Representatives of special interests, such as employees, local communities or the environment, commonly invited to participate in stakeholder panels to review company performance and/or reporting practices;

- Co-implementers, such as NGOs, who have partnered with the company to implement a joint solution or program to address a shared challenge.

Stakeholders can only be well informed and knowledgeable if companies are transparent and report on issues that impact stakeholders. Both parties have an obligation to communicate sincerely and attempt to understand, not just be understood.

**TYPES OF STAKEHOLDERS**

The concept of stakeholders may be classified into Primary and Secondary Stakeholders:

- **Primary stakeholders** are those whose continued association is absolutely necessary for a firm’s survival; these include employees, customers, investors, and shareholders, as well as the governments and communities that provide necessary infrastructure.

- **Secondary stakeholders** do not typically engage in transactions with a company and thus are not essential for its survival; these include the media, trade associations, and special interest groups.

Both primary and secondary stakeholders embrace specific values and standards that dictate what constitutes acceptable or unacceptable corporate behaviors. While primary groups may present more day-to-day concerns, secondary groups cannot be ignored or given less consideration in the ethical decision-making process.

**THE CAUX ROUND TABLE**

The Caux Round Table (CRT) is an international network of business leaders working to promote a morally and sustainable way of doing business. The CRT believes that its Principles for Responsible Business provide necessary foundations for a fair, free and transparent global society.

The Caux Round Table was founded in 1986 by Frits Philips Sr, former President of Philips Electronics, and Olivier Giscard d’Estaing, former Vice-Chairman of INSEAD, as a means of reducing escalating international trade tensions between Europe, Japan and the USA.

At the urging of Ryuzaburo Kaku, then Chairman of Canon, Inc, the CRT began to focus attention on the importance of global corporate responsibility in reducing social and economic threats to world peace and stability. This led to the development of the 1994 Caux Round Table Principles for Business around **three ethical foundations**, namely: responsible stewardship; the Japanese concept of Kyosei - living and working for mutual advantage; and respecting and protecting human dignity. These principles recognize that while laws and market forces are necessary, they are insufficient guides for responsible business conduct.

**CRT Principles for Responsible Business**

The 2009 CRT Principles for Responsible Business comprise seven principles and more detailed...
Stakeholder Management Guidelines covering each of the key stakeholder dimensions of ethical business practices: customers, employees, shareholders, suppliers, competitors, and communities.

The Caux Round Table believes that the world business community should play an important role in improving economic and social conditions. Through an extensive and collaborative process in 1994, business leaders developed the CRT Principles for Business to embody the aspiration of principled business leadership.

The CRT Principles for Business are a worldwide vision for ethical and responsible corporate behavior and serve as a foundation for action for business leaders worldwide. As a statement of aspirations, The CRT Principles aim to express a world standard against which business behavior can be measured.

The Caux Round Table has sought to begin a process that identifies shared values, reconciles differing values, and thereby develops a shared perspective on business behavior acceptable to and honored by all.

These principles are rooted in two basic ethical ideals: kyosei and human dignity:

- **Kyosei**: The Japanese concept of kyosei means living and working together for the common good enabling cooperation and mutual prosperity to coexist with healthy and fair competition.

- **Human dignity**: It refers to the sacredness or value of each person as an end, not simply as a mean to the fulfilment of others purposes or even majority prescription.

**Principles for Responsible Business**

The Caux Round Table (CRT) Principles for Responsible Business set forth ethical norms for acceptable businesses behaviour.

Trust and confidence sustain free markets and ethical business practices provide the basis for such trust and confidence. But lapses in business integrity, whether among the few or the many, compromise such trust and hence the ability of business to serve humanity’s needs.

Events like the 2009 global financial crisis have highlighted the necessity of sound ethical practices across the business world. Such failures of governance and ethics cannot be tolerated as they seriously tarnish the positive contributions of responsible business to higher standards of living and the empowerment of individuals around the world.

The self-interested pursuit of profit, with no concern for other stakeholders, will ultimately lead to business failure and, at times, to counterproductive regulation. Consequently, business leaders must always assert ethical leadership so as to protect the foundations of sustainable prosperity.

It is equally clear that if capitalism is to be respected, and so sustain itself for global prosperity, it must be both responsible and moral. Business therefore needs a moral compass in addition to its practical reliance on measures of profit and loss.

**The CRT Principles**

The Caux Round Table’s approach to responsible business consists of seven core principles as detailed below. The principles recognize that while laws and market forces are necessary, they are insufficient guides for responsible business conduct.

The principles are rooted in three ethical foundations for responsible business and for a fair and functioning society more generally, namely: responsible stewardship; living and working for mutual advantage; and the respect and protection of human dignity.
The principles also have a risk management foundation - because good ethics is good risk management. And they balance the interests of business with the aspirations of society to ensure sustainable and mutual prosperity for all.

The CRT Principles for Responsible Business are supported by more detailed Stakeholder Management Guidelines covering each key dimension of business success: customers, employees, shareholders, suppliers, competitors, and communities. These Stakeholder Management Guidelines can be found at Attachment A below.

**PRINCIPLE 1 - RESPECT STAKEHOLDERS BEYOND SHAREHOLDERS**

- A responsible business acknowledges its duty to contribute value to society through the wealth and employment it creates and the products and services it provides to consumers.

- A responsible business maintains its economic health and viability not just for shareholders, but also for other stakeholders.

- A responsible business respects the interests of, and acts with honesty and fairness towards, its customers, employees, suppliers, competitors, and the broader community.

**PRINCIPLE 2 – CONTRIBUTE TO ECONOMIC, SOCIAL AND ENVIRONMENTAL DEVELOPMENT**

- A responsible business recognizes that business cannot sustainably prosper in societies that are failing or lacking in economic development.

- A responsible business therefore contributes to the economic, social and environmental development of the communities in which it operates, in order to sustain its essential ‘operating’ capital – financial, social, environmental, and all forms of goodwill.

- A responsible business enhances society through effective and prudent use of resources, free and fair competition, and innovation in technology and business practices.

**PRINCIPLE 3 – BUILD TRUST BY GOING BEYOND THE LETTER OF THE LAW**

- A responsible business recognizes that some business behaviors, although legal, can nevertheless have adverse consequences for stakeholders.

- A responsible business therefore adheres to the spirit and intent behind the law, as well as the letter of the law, which requires conduct that goes beyond minimum legal obligations.

- A responsible business always operates with candor, truthfulness, and transparency, and keeps its promises.

**PRINCIPLE 4 – RESPECT RULES AND CONVENTIONS**

- A responsible business respects the local cultures and traditions in the communities in which it operates, consistent with fundamental principles of fairness and equality.

- A responsible business, everywhere it operates, respects all applicable national and international laws, regulations and conventions, while trading fairly and competitively.

**PRINCIPLE 5 – SUPPORT RESPONSIBLE GLOBALISATION**

- A responsible business, as a participant in the global marketplace, supports open and fair multilateral trade.
- A responsible business supports reform of domestic rules and regulations where they unreasonably hinder global commerce.

**PRINCIPLE 6 – RESPECT THE ENVIRONMENT**

- A responsible business protects and, where possible, improves the environment, and avoids wasteful use of resources.

- A responsible business ensures that its operations comply with best environmental management practices consistent with meeting the needs of today without compromising the needs of future generations.

**PRINCIPLE 7 – AVOID ILLICIT ACTIVITIES**

- A responsible business does not participate in, or condone, corrupt practices, bribery, money laundering, or other illicit activities.

- A responsible business does not participate in or facilitate transactions linked to or supporting terrorist activities, drug trafficking or any other illicit activity.

- A responsible business actively supports the reduction and prevention of all such illegal and illicit activities.

**CRT Stakeholder Management Guidelines**

The Caux Round Table’s (CRT) Stakeholder Management Guidelines supplement the CRT Principles for Responsible Business with more specific standards for engaging with key stakeholder constituencies.

The key stakeholder constituencies are those who contribute to the success and sustainability of business enterprise. Customers provide cash flow by purchasing good and services; employees produce the goods and services sold, owners and other investors provide funds for the business; suppliers provide vital resources; competitors provide efficient markets; communities provide social capital and operational security for the business; and the environment provides natural resources and other essential conditions.

In turn, key stakeholders are dependent on business for their well-being and prosperity. They are the beneficiaries of ethical business practices.

**1. Customers**

A responsible business treats its customers with respect and dignity. Business therefore has a responsibility to:

a. Provide customers with the highest quality products and services consistent with their requirements.

b. Treat customers fairly in all aspects of business transactions, including providing a high level of service and remedies for product or service problems or dissatisfaction.

c. Ensure that the health and safety of customers is protected.

d. Protect customers from harmful environmental impacts of products and services.

e. Respect the human rights, dignity and the culture of customers in the way products and services are offered, marketed, and advertised.


2. Employees

A responsible business treats every employee with dignity and respects their interests. Business therefore has a responsibility to:

a. Provide jobs and compensation that contribute to improved living standards
b. Provide working conditions that protect each employee’s health and safety.
c. Provide working conditions that enhance each employee’s well-being as citizens, family members, and capable and caring individuals
d. Be open and honest with employees in sharing information, limited only by legal and competitive constraints.
e. Listen to employees and act in good faith on employee complaints and issues.
f. Avoid discriminatory practices and provide equal treatment, opportunity and pay in areas such as gender, age, race, and religion.
g. Support the employment of differently-abled people in places of work where they can be productive.
h. Encourage and assist all employees in developing relevant skills and knowledge.
i. Be sensitive to the impacts of unemployment and work with governments, employee groups and other agencies in addressing any employee dislocations.
j. Ensure that all executive compensation and incentives further the achievement of long-term wealth creation, reward prudent risk management, and discourage excessive risk taking.
k. Avoid illicit or abusive child labor practices.

3. Shareholders

A responsible business acts with care and loyalty towards its shareholders and in good faith for the best interests of the corporation. Business therefore has a responsibility to:

a. Apply professional and diligent management in order to secure fair, sustainable and competitive returns on shareholder investments.
b. Disclose relevant information to shareholders, subject only to legal requirements and competitive constraints.
c. Conserve, protect, and increase shareholder wealth.
d. Respect shareholder views, complaints, and formal resolutions.

4. Suppliers

A responsible business treats its suppliers and subcontractors with fairness, truthfulness and mutual respect. Business therefore has a responsibility to:

a. Pursue fairness and truthfulness in supplier and subcontractor relationships, including pricing, licensing, and payment in accordance with agreed terms of trade.
b. Ensure that business supplier and subcontractor activities are free from coercion and threats.
c. Foster long-term stability in the supplier relationships in return for value, quality, competitiveness and reliability.
d. Share information with suppliers and integrate them into business planning.
e. Seek, encourage and prefer suppliers and subcontractors whose employment practices respect
human rights and dignity.

f. Seek, encourage and prefer suppliers and subcontractors whose environmental practices meet best practice standards.

### 5. Competitors

A responsible business engages in fair competition which is a basic requirement for increasing the wealth of nations and ultimately for making possible the just distribution of goods and services. Business therefore has a responsibility to:

a. Foster open markets for trade and investment.

b. Promote competitive behavior that is socially and environmentally responsible and demonstrates mutual respect among competitors.

c. Not participate in anti-competitive or collusive arrangements or tolerate questionable payments or favors to secure competitive advantage.

d. Respect both tangible and intellectual property rights.

e. Refuse to acquire commercial information through dishonest or unethical means, such as industrial espionage.

### 6. Communities

As a global corporate citizen, a responsible business actively contributes to good public policy and to human rights in the communities in which it operates. Business therefore has a responsibility to:

a. Respect human rights and democratic institutions, and promote them wherever practicable.

b. Recognize government’s legitimate obligation to society at large and support public policies and practices that promote social capital.

c. Promote harmonious relations between business and other segments of society.

d. Collaborate with community initiatives seeking to raise standards of health, education, workplace safety and economic well-being.

e. Promote sustainable development in order to preserve and enhance the physical environment while conserving the earth’s resources.

f. Support peace, security and the rule of law.

g. Respect social diversity including local cultures and minority communities.

h. Be a good corporate citizen through ongoing community investment and support for employee participation in community and civic affairs.

### THE CLARKSON PRINCIPLES OF STAKEHOLDER MANAGEMENT

The year after his retirement from the faculty of the University of Toronto in 1988, Max Clarkson (1922-1998) founded the Centre for Corporate Social Performance and Ethics in the Faculty of Management, now the Clarkson Centre for Business Ethics & Board Effectiveness, or CC(BE) 2. Four conferences hosted by the Centre between 1993 and 1998 brought together management scholars to share ideas on stakeholder theory, an emerging field of study examining the relationships and responsibilities of a corporation to employees, customers, suppliers, society, and the environment. The Alfred P. Sloan Foundation funded the project, from which the Clarkson Principles emerged.
After an introduction to the stakeholder concept with comments on shareowners and the legal and moral duty of managers, seven (7) principles of Stakeholder Management are set forth, each with a paragraph or two expanding on its meaning. These principles represent an early stage general awareness of corporate governance concerns that have been widely discussed in connection with the business scandals of 2002.

- **Principle 1:** Managers should acknowledge and actively monitor the concerns of all legitimate stakeholders, and should take their interests appropriately into account in decision-making and operations.

- **Principle 2:** Managers should listen to and openly communicate with stakeholders about their respective concerns and contributions, and about the risks that they assume because of their involvement with the corporation.

- **Principle 3:** Managers should adopt processes and modes of behavior that are sensitive to the concerns and capabilities of each stakeholder constituency.

- **Principle 4:** Managers should recognize the interdependence of efforts and rewards among stakeholders, and should attempt to achieve a fair distribution of the benefits and burdens of corporate activity among them, taking into account their respective risks and vulnerabilities.

- **Principle 5:** Managers should work cooperatively with other entities, both public and private, to insure that risks and harms arising from corporate activities are minimized and, where they cannot be avoided, appropriately compensated.

- **Principle 6:** Managers should avoid altogether activities that might jeopardize inalienable human rights (e.g., the right to life) or give rise to risks which, if clearly understood, would be patently unacceptable to relevant stakeholders.

- **Principle 7:** Managers should acknowledge the potential conflicts between (a) their own role as corporate stakeholders, and (b) their legal and moral responsibilities for the interests of stakeholders, and should address such conflicts through open communication, appropriate reporting and incentive systems, and, where necessary, third party review.

In many ways, the Clarkson Principles are “meta-principles” that encourage management to embrace specific stakeholder principles and then to implement them in accordance with the norms listed above. Their current use seems largely hortatory, unlike principles or codes that call for formal adoption by managers or corporations.

**GOVERNANCE PARADIGM AND VARIOUS STAKEHOLDERS**

(a) **Employees:**

Earlier it was believed that shareholder’s primacy is supreme since they have contributed towards the capital and it leaves out role of employees. However with the growing that capital alone cannot do miracle and labour is also an equally important factor of the production.

Employee participation in corporate governance systems can be found in many countries and corporations throughout the world. Following are the some important example for ensuring good governance by employees:

- Right to consultation - where employees must be consulted on certain management decisions. This right increases transparency of management decisions and allows employee opinion to ameliorate the asymmetry of information between management and the market.
**Right to nominate/vote for supervisory board members** - In many cases employee participation on the board is mandated. This right creates a check and balance system between management and the supervisory board, which in turn creates the perception of greater fairness.

**Compensation/privatization programs** that make employees holders of shares, thereby empowering employees to elect the board members, which, in turn holds management responsible.

**Participation in the capital**: Employees may be partner in the capital contribution. They may be given the shares under the ESOP scheme. This will create the belongingness of the ownership concept among the employees meaning there by owner as well as employee. This will lead to the Improved employee commitment and buy-in to management’s goals side by side the alignment of interest between employees and shareholders. It may support the emergence of more transparent and effective corporate governance.

**Profit sharing**: The profit-sharing plans should be broad-based (all or most employees) rather than for executives only. This can be done in a variety of ways like: Cash-based sharing of annual profits, Deferred profit-sharing. The advantages of it are Encourage employee involvement, improve motivation, Improve distribution of wealth and Wage flexibility can improve firm performance.

**Whistle Blower Policy**: A whistle blower is the one who exposes wrongdoing, fraud, corruption or misconmanagement in an organization. A whistle blower is a person who publicly complains/discloses the concealed misconduct on the part of an organization or body of people, usually from within that same organisation. Whistle blower may be an employee, former employee, vendor, customer or other stakeholder. Whistle blowers are important stakeholders as they can work as a tool for authorities to get information of deviant behaviour or practices in organizations.

The big question is that in an organization where although lots of people are work, who will take chance against the possible risk involved? Who would blow the whistle about the wrongdoing/malpractices going on inside an organization? It’s not only about just raising alarm, it is more about the impartiality and courage to start with.

Whistle blower needs protection against retaliation/misbehavior by superiors. At the corporate level, the companies can provide protection to whistle blowers by establishing a well documented “Whistle Blower Policy” and ensuring its effectiveness practically. Just making a documented policy is not sufficient to develop confidence among the employees; examples should be set by taking action against the wrongdoing reported.

**Customers:**

The business activity runs around the customer. There is a maxim ‘Caveat Emptor’ means let the buyer beware. However, to run the business in long term, the concept has to re-think else the competitor will take advantage of it. Today the customer satisfaction is one of the most important aspects of firm’s performance.

In today’s global environment, customers have innumerable choices. Therefore, corporate need to establish a differentiation. The differentiation is established in terms of quality and price of the product or service. Customers are also driving corporate to consider environmental factors in designing the products and services.

Over and above this, the customers consider the reputation which a corporate builds. The trust and loyalty that an organization earns is based on its successful delivery over a long period of time.

Governance plays a big role in improving the relation between the organization and the customer (building
customer trust and commitment) which eventually leads to better performance for the organization especially if you take into consideration that the cost of new customer is five to six times more than maintaining the current customer.

(c) Lenders:

Lenders normally are the banks and financial institutions. They provide the term loan as well as the working capital. While giving the credit facilities to any concerns, apart from the financial strength, project viability, income generation of the organization, lenders also like to ensure about the other aspects like market reputation, compliance culture prevailing in the organization and adherence to the ethical standards and adoption of corporate governance practices.

When a company borrows money, a loan contract typically includes covenants or promises made by its management that either guide or limit its actions. If a borrower violates a covenant, the creditor can opt to demand immediate repayment even though the borrower has not defaulted. Lending institutions many times places its nominee as a director on the Board of borrowing companies.

Lenders may include covenants relating to environment and sustainability. The Equator Principles is a risk management framework, adopted by financial institutions, for determining, assessing and managing environmental and social risk in projects and is primarily intended to provide a minimum standard for due diligence to support responsible risk decision-making.

(d) Vendors:

Vendors play a key role in the success of an organisation. The organisation which builds a mutually strong relationship with its vendors improves its overall performance in the marketplace. The time, money and energy used to nurture a positive vendor relationship cannot be measured directly against the company's bottom line. However, a well managed vendor relationship will result in increased customer satisfaction, reduced costs, better quality, and better service from the vendor. It ultimately contributes toward the good governance of an organisation. A proper systematic approach of vendor management will benefits all the employees, organisation, customer and vendors.

(e) Government:

Government is the largest stakeholder. Government policy and the legal environment set the tone for the desired corporate governance practices by the corporate sector. Government in any country plays a key role in setting the mandatory limit and recognition of voluntary efforts of corporate sector. Since, it is a well maintained proposition that you can’t legislate good behavior, therefore, the Government role is to differentiate between the voluntary and mandatory measures becomes more important so that in regulatory role, it should not burden the corporate sector with the legal compliances.

The government role is to provide an ease environment for the corporate sector as well as to take care of the interest of other stakeholders. The government acts as a major player between the Corporate and Stakeholders by facilitating both of them.

Further beyond the law, government may directly influence the corporate governance practices of the corporate sector by providing voluntary measure and recognition in the respect of Corporate Governance measures.

(f) Society:

What society wants from good governance in the aggregate is maximum production of economic well-being. This requires innovation and experimentation as well as it also requires control, probity, and risk
management to seize the activities involving hazard to the local community. Now a day's Companies are spending voluntarily for the social and community development which is well recognized by the society and government as well.

Business was perceived to maximize profit by exploiting environmental and social systems. These perceptions and attitude forced society to revalue their expectations from business. It was realized that increased economic development at all costs would not be desirable. Only industrial development which does not reduce the quality of life should be encouraged. Thus if businesses do not have in a socially responsible manner, their activities will have a negative impact on the society and the society will have a negative impact. As a result of change in society’s attitude towards business, relations between society and business firms first became strained, and this change triggered a sense of frustration for corporate management in the early stage of this awareness.

In today globalised world, the Corporate sector is growing day by day which combining the economic value creation and development of wealth for its stakeholders including society. The society being an important element for a company can’t be ignored to be part of this development. The society provides the desired climate for successful operation of a company business. If society turns against the company, then business lose its faith in the eyes of other stakeholders be it government or customer.

The good governed companies always value for the society in which they operate their business. The companies need to understand the expectation of society form them and should strive to give maximum for the society according to the need.

Society can ensure good governance of companies as they are one of the major stakeholders representing the environmental and social concern apart from the government mandate to the companies.

DEALING WITH INVESTOR ASSOCIATIONS, PROXY ADVISORY FIRMS AND INSTITUTIONAL INVESTORS

Investor Associations are with a common interest in promoting shareholder rights and responsibilities. These associations contribute to investor protection a lot.

Proxy advisory firms are independent research outfits that evaluate the pros and cons of corporate matters such as mergers, acquisitions, top appointments and CEO pay, which shareholders are expected to vote on in AGMs, EGMs or court-convened meetings. These firms engage in heavy-duty analysis of the major actions that are put to vote, and produce detailed reports advising shareholders on how they should swing to safeguard their interest. Proxy advisory firms charge fees to institutional investors and provide regular, independent voting recommendations on the companies that the latter own.

Proxy advisers can be valuable because they fill an information gap: institutional investors contract with these firms to carry out comprehensive reviews of voting proposals that the investors themselves have neither the time nor the resources to undertake. In short, many institutional investors, including pension funds and mutual funds, review and perhaps follow proxy advisers’ recommendations when voting their shares.

Over the years, proxy services firms have played an increasingly outsized role in imposing their views of appropriate corporate governance on corporations and their shareholders. These firms purport to evaluate every issue for which corporate proxies are solicited, and their recommendations are demonstrably influential in how proxy votes are cast. Following are few reasons why institutional investors engage proxy advisors:

(i) Proxy advisors generally offer variety of services consisting of both, analyzing the proposals at general meetings and recommending voting decisions.
(ii) The recommendations of proxy advisors help the investors to obtain a more considered understanding of different agenda items and to arrive at an informed voting decision, allowing them to optimise their own limited resources and cast their votes in a timely and informed manner.

(iii) Considering that institutional investors invest in multiple companies in different industry range and across the globe, it may not be feasible for those investors to have informed knowledge of the corporate governance specifications of that country and hence there may be an inability to understand the need and impact of a particular agenda item. Proxy advisors help to combat this issue as well through their informed consultancy. Due to cross border voting investors may face issues in terms of language of a country. The proxy advisors can assist in mitigating the language issues as well. Further, they may also enable the investors to have a voting platform in cases where electronic voting is a pre-requisite at general meetings.

(iv) Apart from the above, general meetings across the globe may be concentrated during a certain period of the year and therefore the investors may not be in a position to gather information and knowledge about all the companies and hence, may not be in a position to take informed decision while voting. Proxy services industry emerged and expanded with the growth of institutional investors and shareholder activism. Proxy services firms play an important role in the proxy voting system. Such firms offer valuable services which includes analysing of the proposals for general meetings and providing voting recommendations, either based on the their own voting policy or on the investor’s customised voting policy.

Proxy advisers also influence boards’ decision making. They do a good job of policing the boards and governance records of the firms they track, and nudging institutional investors to take a stand on governance issues.

Institutional investors are financial institutions that accept funds from third parties for investment in their own name but on such parties’ behalf. They include pension funds, mutual funds and insurance companies. These pools a large capital and companies should always work with them harmoniously.

Companies should consider implementing the following practices, while dealing with investors:

• Preparing (in advance) materials articulating positions vis-à-vis significant issues to be submitted to a shareholder vote, addressing major rationales supporting a view contrary to the views the public company intends to espouse;
• Consistent with disseminating or otherwise making materials addressing shareholder voting issues available to proxy services firms, current investors, company social media outlets, various media outlet representatives covering the companies;
• Formally seeking opportunities to meet with proxy services firms on issues subject to shareholder votes—in advance of proxy services firm issuance of recommendations (if possible), and immediately after recommendations are made—to ensure that predicates for recommendations are accurate and up to date;
• Contemporaneously documenting proxy services firm responses to meeting requests, as well as substantive discussions at any meetings;
• Formally requesting that proxy services firms provide previews of recommendations they anticipate making vis-à-vis issues to be submitted to public company shareholders for a vote;
• Contemporaneously documenting proxy services firm responses to preview requests (and any substantive discussions about ensuing proxy services firm recommendations); and
• Monitoring proxy services firm recommendations for accuracy or reliance on outdated information.

The relationship between companies and their investors both individual and institutional is very crucial. The companies should:

• encourage investors to communicate directly their preferences, expectations and policies to the company;

• provide meaningful communications about strategy, long-term objectives and governance, and encourage investors to actively listen to companies and review these communications;

• establish and maintain meaningful, direct long-term relationships with significant investors and encourage those investors to have the appropriate policies, personnel and procedures for meaningful reciprocity in the relationship; and

• where companies are pursuing subpar strategies that are unlikely to bring long-term success, encourage investors to use behind-the-scenes, direct engagement with the companies as a first line of action.

Companies should continue to engage in year-round, regular communications with institutional investors, to develop and maintain a relationship of trust and confidence, and also provide companies with an opportunity to bring concerns about the actions (or inaction) of proxy services firms to the attention of investors.

Companies can serve their shareholders by maintaining a continuous dialogue with proxy services firms in order to correct erroneous or stale information, or to address any troublesome recommendations that do not advance the best interests of the shareholders.

CONCLUSION

Whose interest and for whose benefit the corporations are running? The answer to this question is certainly for the Stakeholder (and not for shareholders alone). The every activity in the organization should be in the interest of all the stakeholders since stakeholders provide resources that are more or less critical to a firm’s long-term success.

Gone are the days when fundamental purpose was to maximise corporate profit with a view to increasing shareholder wealth. It has been now realised that the ‘modern corporation by its nature creates interdependencies with a variety of groups with whom the corporation has a legitimate concern, such as employees, customers, suppliers and members of the communities in which the corporation operates.

GLOSSARY OF TECHNICAL WORDS

• Analytical: this ia a way of doing something that involves the use of logical reasoning.

• Capitalism: an economic system characterized by private or corporate ownership of capital goods, by investments that are determined by private decision, and by prices, production, and the distribution of goods that are determined mainly by competition in a free market.

• Normative: relating to, or determining norms or standards / conforming to or based on norms.

• Coexist: to exist together or at the same time / to live in peace with each other especially as a matter of policy.

LESSON ROUND UP:

• “Stakeholder Theory is an idea about how business really works. It says that for any business to be successful it has to create value for customers, suppliers, employees, communities and financiers, shareholders, banks and others people with the money.”
R. Edward Freeman defined Stakeholder Theory in broad definition of a stakeholder is any group or individual which can affect or is affected by an organization." Such a broad conception would include suppliers, customers, stockholders, employees, the media, political action groups, communities, and governments.

A more narrow view of stakeholder would include employees, suppliers, customers, financial institutions, and local communities where the corporation does its business. But in either case, the claims on corporate conscience are considerably greater than the imperatives of maximizing financial return to stockholders.

Stakeholder engagement is the process by which an organisation involves people who may be affected by the decisions it makes or can influence the implementation of its decisions.

The concept of stakeholders may be classified into Primary and Secondary Stakeholders.

The 2009 CRT Principles for Responsible Business comprise seven principles and more detailed Stakeholder Management Guidelines covering each of the key stakeholder dimensions of ethical business practices: customers, employees, shareholders, suppliers, competitors, and communities.

The CRT Principles for Responsible Business are supported by more detailed Stakeholder Management Guidelines covering each key dimension of business success: customers, employees, shareholders, suppliers, competitors, and communities.

Carlson introduced seven Principles of Stakeholder Management.

REFERENCE FOR FURTHER READING

http://www.stakeholdermap.com/stakeholder-theory.htm
http://lexicon.ft.com/Term?term=stakeholder-theory
http://www.businessdictionary.com/definition/stakeholder-theory.html
http://www.referenceforbusiness.com/encyclopedia/Sel-Str/Stakeholder-Theory.htm
https://www.thehindubusinessline.com/opinion/columns/slate/all-you-wanted-to-know-about-proxy-advisory-services/article9395194.ece

SELF-TEST QUESTIONS:

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Why the concept form shareholder to stakeholder changed and what are the benefits of it?
2. Define the stakeholder theory and its principles.
3. List out the seven principles of stakeholder management as suggested by Carlson with brief descriptions.
4. What were the recommendations of the Caux Round Table (CRT)?
5. Write short notes on (i) Stakeholder Engagement (ii) Stakeholder Analysis
Lesson 8
Governance and Compliance Risk

LESSON OUTLINE

- Introduction
- Indian Scenario
- Compliance
- Corporate Compliance Management
- Significance of Corporate Compliance Management
- Compliance Risk
- Consequences of Non-compliance
- Managing Compliance Risk
- New Developments – Governance and Risk Compliance (GRC)
- Conclusion
- Glossary
- Lesson Round-Up
- Self Test Questions

LEARNING OBJECTIVES

The objective of this study lesson is to enable the students to understand the concept of compliance to apprise about the corporate compliance and to brief about the historic origin, need and management.

This chapter also describes the importance of corporate compliance management, compliance risks and consequences of non-compliance. This chapter also explains the new developments in Governance and Risk Compliances (GRC).

This chapter provides working knowledge on governance and compliance risks, which may be useful in performing advisory role in practical areas of work.

Open Compliance & Ethics Group (OCEG)(anon-profit organization that uniquely helps other organizations to enhance corporate culture and integrate governance, risk management, and compliance processes).
INTRODUCTION

“Governance is the culture, values, mission, structure, layers of policies, processes and measures by which organizations are directed and controlled”

Governance defines how the organization should perform, describing through policies what is acceptable and unacceptable and compliance is the area responsible for inspecting and proving that they are: adequate, being implemented and followed.

Governance is also responsible for risk and compliance oversight, as well as evaluating performance against enterprise objectives. The board acts as an active monitor for shareholders’ and stakeholders’ benefit, with the goal of Board oversight to make management accountable, and thus more effective. Accordingly, governance should be able to understand and foresee the organization’s vulnerabilities and, hence make decisions to reduce them. Also, governance should distribute power to provide insight and intelligence, at the right time, so that the right people in the management can make risk-aware decisions in accordance with key business objectives. Risk-awareness is possible through the close proximity that governance should have with risk management, which may provide very useful information in strategy setting and decision making.

Governance needs to touch every part of the organization. It needs to be at the heart of corporate culture when in today’s complex global ecosystems, risks are becoming more interconnected.

Today markets, economies and business networks are so deeply interconnected that a single risk event can cause widespread disruption. Risks themselves are becoming more interconnected. The World Economic Forum’s report on the top risks of 2017 emphasized how deep the links are between risks such as unemployment and social instability. Even regulatory enforcement risks are crossing boundaries, as is evident through corporations being fined by cross-jurisdictional regulators. Today, compliance risks are not just compliance risks; they are also reputational risks, strategic risks, and financial risks. It is crucial to understand these interconnections to build risk maturity.

With the advent of a younger workforce and technologies such as the cloud and mobility, the emphasis is on the consumerization. People want simple and contextual information and accessibility available to them anywhere, anytime. Efficiency is also becoming important. Today, companies need to know less about what happened, and more about what is happening, what is likely to happen, and what needs to be done – the possible scenarios, decisions, and constraints. They also need to be able to tie all this information back to their core business performance.

If companies want to move up the risk maturity curve, they need to find ways of tying various Governance and Compliance elements together with risks.

Compliance with law and regulation must be managed as an integral part of any corporate strategy. The board of directors and management must recognize the scope and implications of laws and regulations that apply to the company. They must establish a compliance management system as a supporting system of risk management system as it reduces compliance risk to a great extent. To ensure an effective approach to compliance, the participation of senior management in the development and maintenance of a compliance program is necessary. They should review the effectiveness of its compliance management system at periodic intervals, so as to ensure that it remains updated and relevant in terms of modifications/ changes in regulatory regime including acts, rules, regulations etc. and business environment.

INDIAN SCENARIO

In the recent years, India has also seen a spurt of corporate scams and cases of corporate espionage. This has resulted in an urgent need for a strong corporate compliance function.
A Deloitte compliance survey of 2015 has the following insights:

- 62% Indian organizations have a designated Chief Compliance Officer (CCO) as compared to 70% global organizations.
- Only 26% Indian respondents have a full-time CCO as compared to 58% respondents globally. Also, 51% companies have a staff of five or fewer employees. It is expected that an increased number of companies will have a full-time CCO, given the heightened expectations under various laws.
- Only 14% organizations outsource or co-source their employee and ethics hotline as compared to 39% organizations globally.
- Approximately 92% respondents mentioned Code of Conduct as a key area of priority of the compliance function as compared to the global figure of 73%. However, Indian companies still need to focus on compliance training, compliance strategy processes, and policy management as they are lagging behind in these areas as compared to global companies.
- The number of organizations who measure the effectiveness of their compliance programs continues to increase to 57% but there is still a long way to go. The most common metrics used by CCOs to gauge effectiveness are internally focused: internal audits, analysis of self-assessment results, feedback from employee ethics survey, etc.
- Almost 16% of respondents were not confident that their IT systems captured and reported all compliance data necessary to get a good sense of effectiveness. That might be because many compliance tasks—policy management, document management, risk assessments, regulatory reviews—still rely heavily on desktop software applications.

Bribery and corruption continue to pose significant challenges in India. Corporate India is now slowly taking steps in the right direction in principle but still not investing enough in practice. An effective compliance plan would ideally include more than just an increase in budget allocated. It would involve the establishment of leading global practices, policies and procedures.

Some recent (and important) regulatory and judicial efforts in this direction are:

**Bribery and Corruption**

**Global Scenarios**

**US:** The deterrence of bribery and corruption is one of the primary issues for governments worldwide. The US Foreign Corrupt Practices Act, 1977 (FCPA), which prohibits businesses from bribing foreign officials and political figures, remains the most robustly enforced anti-bribery and anti-corruption (ABAC) legislation globally. The US Department of Justice and the Securities and Exchange Commission take the lead in its enforcement. The core aim of the Foreign Corrupt Practices Act (FCPA) is to prohibit companies and their individual officers from influencing foreign officials with any personal payments or rewards. The FCPA applies to any person who has a certain degree of connection to the United States and engages in corrupt practices abroad, as well as to U.S. businesses, foreign corporations trading securities in the U.S., American nationals, citizens, and residents acting in furtherance of a foreign corrupt practice, whether or not they are physically present in the U.S. This is considered the nationality principle of the Act. Any individuals involved in these activities may face prison time. In the case of foreign natural and legal persons, the Act covers their deeds if they are in the U.S. at the time of the corrupt conduct. This is considered the protective principle of the Act.
UK: The Bribery Act 2010 is an Act of the Parliament of the United Kingdom that covers the criminal law relating to bribery. Introduced to Parliament in the Queen's Speech in 2009 after several decades of reports and draft bills, the Act received the Royal Assent on 8 April 2010 following cross-party support. Initially scheduled to enter into force in April 2010, this was changed to 1 July 2011. The Act repeals all previous statutory and common law provisions in relation to bribery, instead replacing them with the crimes of bribery, being bribed, the bribery of foreign public officials, and the failure of a commercial organisation to prevent bribery on its behalf.

The penalties for committing a crime under the Act are a maximum of 10 years’ imprisonment, along with an unlimited fine, and the potential for the confiscation of property under the Proceeds of Crime Act 2002, as well as the disqualification of directors under the Company Directors Disqualification Act 1986. The Act has a near-universal jurisdiction, allowing for the prosecution of an individual or company with links to the United Kingdom, regardless of where the crime occurred. Described as “the toughest anti-corruption legislation in the world”,[1] concerns have been raised that the Act's provisions criminalize behaviour that is acceptable in the global market, and puts British business at a competitive disadvantage.

The main differences between the Bribery Act and the FCPA

The main differences between the Bribery Act and the FCPA are as follows:

- **Bribery of foreign (public) officials:** Both the Bribery Act and the FCPA make it an offence to bribe foreign (public) officials. Under the Bribery Act a “foreign public official” is defined more narrowly than under the FCPA but still includes (i) anyone who holds a foreign legislative or judicial position; (ii) individuals who exercise a public function for a foreign country, territory, public agency or public enterprise; or (iii) any official or agent of a public organisation.

- **Private-to-private bribery:** The FCPA does not cover bribery on a private level, unlike the Bribery Act, although such conduct can be caught under other US legislation.

- **Active and passive bribery:** The FCPA only covers active bribery, that is to say the giving of a bribe. In contrast, the Bribery Act prohibits both active and passive bribery i.e. the taking of a bribe.

- **Failure to prevent bribery:** The Bribery Act creates a strict liability corporate offence for failure to prevent bribery (as opposed to vicarious liability) subject to being able to establish that a company has “adequate procedures”. Under the FCPA, however, a company subject to US jurisdiction can be held vicariously liable for acts of its employees and agents. The UK offence extends to acts of “associated persons” which means anyone who performs services for or on behalf of the commercial organisation.

- **Intent:** Under the FCPA it must be proved that the person offering the bribe did so with a “corrupt” intent. The Bribery Act makes no requirement for a “corrupt” or “improper” intent in relation to the bribery of a foreign public official, although the requirement remains for the general bribery offence.

- **Facilitation payments:** The FCPA creates an exemption for facilitation payments whereas the Bribery Act makes no such exception. The Ministry of Justice guidance, however, confirms that prosecutors will exercise discretion in determining whether to prosecute. In addition, informal guidance received from the SFO indicates that where it is considering action, it will be guided by the following six principles:

1. Whether the company has a clear and issued policy.

2. Whether the company has written guidance available to employees as to the procedures they must follow where a facilitation payment is requested or expected.

3. Whether such procedures are really being followed (monitoring).
4. Evidence that gifts are being recorded at the company.

5. Proper action, collective or otherwise, to inform the appropriate authorities in countries when a breach of the policy occurs.

6. The company is taking what practical steps it can to curtail such payments.

- Promotional expenses: The FCPA provides for a “defence” to promotional expenses in so far as it can be demonstrated that they were a reasonable and bona fide expenditure. There is no such defence concerning promotional expenses under the Bribery Act, in relation to foreign public officials, although the Ministry of Justice has provided some comfort on this aspect in its guidance.

- Penalties: An individual found to have committed an offence under the Bribery Act is liable to imprisonment of up to ten years and/or to an unlimited fine. A company found guilty is subject to an unlimited fine.

For offences committed under the FCPA an individual can be fined up to US$250,000 per violation and may also be given up to five years imprisonment. A company guilty under the FCPA is liable for a fine of up to US$2,000,000 per violation.

**Indian perspective**

**The Lokpal and Lokayuktas Act, 2013**, which created a new ombudsman role to investigate allegations of corruption. The preamble of the said Act states that it is An Act to provide for the establishment of a body of Lokpal for the Union and Lokayukta for States to inquire into allegations of corruption against certain public functionaries and for matters connected therewith or incidental thereto. Whereas the Constitution of India established a Democratic Republic to ensure justice for all; and whereas India has ratified the United Nations Convention Against Corruption; and whereas the Government’s commitment to clean and responsive governance has to be reflected in effective bodies to contain and punish acts of corruption; now, therefore, it is expedient to enact a law, for more effective implementation of the said Convention and to provide for prompt and fair investigation and prosecution in cases of corruption.

**The Prevention of Corruption Act, 1988** states in its preamble that it is an Act to consolidate and amend the law relating to the prevention of corruption and for matters connected therewith.

**Section 7 of the said Prevention of Corruption Act, 1988**, which was substituted by the Prevention of Corruption (Amendment) Act, 2018, and came into force w.e.f. 26-7-2018 specially covers the offence relating to public servant being bribed.

**Prohibition of Benami Property Transactions Act, 1988**: With a view to prevent the benami property transactions major amendments were made in the Prohibition of Benami Property Transactions Act, 1988, by the Benami Transactions (Prohibition) Amendment Act, 2016, w.e.f.1-11-2016. This Act was enacted with a view to prohibit benami transactions and the right to recover property held benami and for matters connected therewith or incidental thereto.

In 2002, the Prevention of Money Laundering Act, 2002 was passed in order to prevent money-laundering and to provide for confiscation of property derived from, or involved in, money-laundering and for matters connected therewith or incidental thereto.

This Act was the outcome of the Political Declaration and Global Programme of Action, annexed to the resolution S-17/2 which was adopted by the General Assembly of the United Nations at its 17th special session on the 23rd day of February, 1990. The Political Declaration adopted by the Special Session of the United Nations General Assembly held on 8th to 10th June, 1998 calls upon the Member States to adopt
national money-laundering legislation and programme; and whereas it is considered necessary to implement
the aforesaid resolution and the Declaration.

Another landmark enactment in this direction was enactment of the Black Money (Undisclosed
Foreign Income and Assets) and Imposition of Tax Act, 2015, which was assented the President of India
26-5-2015. The modus operandi behind the enactment of this Act was to make provisions to deal with the
problem of the Black money that is undisclosed foreign income and assets, the procedure for dealing with
such income and assets to and provide for imposition of tax on any undisclosed foreign income and asset
held outside India and for matters connected therewith or incidental thereto.

Responsibility of Independent Director (IDs) to mitigate and detect fraud

The evolving regulatory landscape has made IDs responsible for mitigating and detecting fraud. (With this,
the risk around non-compliance has increased significantly and organisations need to comply with global
legislations such as FCPA and the UK Bribery Act 2010). For the first time, the Companies Act 2013 has
defined fraud and outlines penalties for an act of fraud. It has enlarged the role, duties and responsibilities of
IDs with respect to fraud prevention and detection. Additionally, it has also imposed heavy responsibilities on
them for vigil checks and corporate governance.

Covering malfeasance in public procurement

The government proposes to pass a law on public procurement which is consistent with the United Nations
Commission on International Trade model. In India, they introduced Public Procurement Bill was in
Parliament in 2012. Then, they sought to regulate procurement by ministries/departments of the central
government. The objective was to ensure transparency, accountability and integrity in the entire procurement
process. It was focused on fair and equitable treatment of bidders, promoting competition and enhancing
efficiency. It also included safeguarding the integrity of the process and enhancing public confidence in
public procurement. However, the bill was not passed by Parliament.

Non-interference of courts in arbitration proceedings

According to the World Bank, there are a large number of pending cases in Indian courts and sluggish
implementation of judicial reforms. It is the key reasons for India’s low rank on the ‘Ease of Doing Business’
index.

In relation to international commercial arbitration, the Supreme Court adopted an interventionist approach in
arbitration matters has substantially changed its stance. Post the decision in the case of BALCO vs Kaiser
Aluminium (2012, Supreme Court), it has been seen that the Indian courts are now less keen to interfere in
arbitration matters. Thus, they adopted a pro-arbitration approach.

Antitrust compliance

The economic principle underlying the reforms is premised on neo-liberal philosophy that the economy
performs best when the market players are allowed to freely respond to the forces of competition with
minimal state interference. The post 1991 economic reform gave greater role to market forces and
encouraged competition in the Indian economy. As India moved steadily on the path of reforms it did away
with the MRTP Act, 1969 as it was realised that the MRTP Act had outlived its utility; and control of size of
enterprises was no longer appropriate to support the growth aspirations of the Indian economy. The
Competition Act, 2002 (herein after referred to as the Act) was enacted in 2003 as a modern economic law.
The Act has since been amended thrice in the years 2007, 2009 and 2017.

The Commission functions as a market regulator for preventing and regulating anti-competitive practices in
the country and to carry on the advisory and advocacy functions in its role as a regulator. Objectives of the Commission as given in the Act are:

(i) preventing practices having adverse effect on competition,

(ii) promoting and sustaining competition in markets,

(iii) protecting the interests of consumers and

(iv) ensuring freedom of trade carried on by other participants in markets in India.

During 2016-17, the Commission took note of 161 allegations related to anti-competitive agreements and abuse of dominant position. On the basis of existence of a prima-facie case, the Commission directed the Director General to undertake investigations into 100 matters and closed 67 matters. The DG completed investigations into 23 matters during the year. The Commission has issued a total of 79 appealable orders imposing an aggregate penalty of Rs. 13,087 crore (Rs. 288 crore in 2016-17) on wrongdoers. The Commission received 113 notices of proposed combinations in 2016-17. It approved a record number of 106 combinations.

Although relatively young in terms of its lifespan, the Competition Commission of India (CCI) has received more than 550 complaints alleging violations. This has been across both private and public sectors, and the number of complaints is increasing exponentially.

The CCI has initiated action against several companies. Till March 2015, it had already imposed penalties of about ₹124 billion. Several Indian corporates are now taking serious steps in order to comply with the antitrust laws in the country. 80% of Indian companies are not even aware about the existence of competition laws in India.

A recent Compliance Risk Study (2018 by Accenture) based on a survey of 150 leading Compliance officers at banking, capital markets and insurance institutions globally provides insight into the different strategies that firms are pursuing to deliver the capabilities that shape a Compliance function. It clearly states that as the industry continues its rapid evolution, the ever-decreasing time between major change events demands a new mindset to modernize the Compliance function. Annual plans, driven by once a-year risk assessment and supported by logical transition states, (that help the function and the organization navigate a better approach to managing risk and improving control), are no longer effective.

Open banking, crypto currency and quantum computing are examples of exogenous shocks to the industry that create uncertainty and test the resilience of Compliance.

**COMPLIANCE**

Historically, boards have been perceived to focus primarily on value creation for shareholders. But with renewed attention to statutory compliance, regulators now also want boards to focus on value management and value protection by doing a formal review of compliance obligations. As a result, corporations are looking to replace informal compliance frameworks with well structured, documented and demonstrable compliance structures that help management monitor and report compliance risk and exposure as well as compliance status to the Board.

The compliance function checks that all relevant laws are being properly complied with. Good corporate governance means “putting the right internal infrastructure to manage the risk that the company faces” (Javier, 2002).

Today, there is a growing awareness that if enterprises want to retain their license to operate, and achieve
their business objectives, while following regulations and managing risks, they need to have a number of different risk management and compliance groups in place – ranging from the board risk and audit committees, to ethics and governance, safety, security, and compliance.

According to OCEG, “compliance is the act of adhering to, and the ability to demonstrate adherence to, mandated requirements defined by laws and regulations, as well as voluntary requirements resulting from contractual obligations and internal policies”. Through this definition, the relation between governance and compliance becomes clearer. Compliant organizations need an effective approach to verify that they are in conformity with external (standards, regulations) and internal (internal policies) rules. This approach is assisted by risk management, which must identify and prioritize risks that are already aligned with corporate objectives defined by governance.

Thus, Compliance should work to develop a new, forward-thinking and stress-tested approach, and to continuously monitor its situation, evaluating and improving its ability to remain resilient in a financial services landscape that is subject to disruption and overnight change.

**Compliance Vs Conformance**

Conformance is voluntary adherence to a standard, rule, specification, requirement, design, process or practice.

Compliance is forced adherence to a law, regulation, rule, process or practice.

Conformance applies to strategies and plans that are adopted to be more productive or to improve quality.

Compliance applies to laws and regulations that one has no option but to follow or face penalties. Such regulations may potentially be productive for society but don't necessarily contribute to an organization's goals.

**Compliance**

Definition of Compliance: The International Compliance Association has defined the term compliance as the ability to act according to an order, set of rules or request. Compliance mainly operates at two levels:

Level 1 - compliance with the external rules that are imposed upon an organisation as a whole. Level 2 - compliance with internal systems of control that are imposed to achieve compliance with the externally imposed rules.

**Goals of Compliance**

The goals of compliance, a compliance program, sometimes called a corporate compliance program or regulatory compliance program, include:

- Compliance with legal and regulatory requirements
- Compliance with internal policies and contracts
- Management of related compliance risks
- Establishment of an ethical culture

**Different aspects of Compliances**

In order to simplify, Compliance, may be divided into
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- Regulatory compliance,
- Corporate compliance,
- Legal compliance and case management.

**Regulatory Compliance**

Regulatory compliance is an organization's adherence to laws, regulations, guidelines and specifications relevant to its business. Violations of regulatory compliance regulations often result in legal punishment, including penalties/ fines.

As the number of rules has increased since the turn of the century, regulatory compliance has become more prominent in a variety of organizations. The trend has even led to the creation of corporate, chief and regulatory compliance officer positions to hire employees whose sole focus is to make sure the organization conforms to stringent, complex legal mandates.

Regulatory compliance varies not only by industry but often by location. The financial, research, and regulatory structures in one country, for example, may be similar but with particularly different in another country. These similarities and differences are often a product of reactions to the changing objectives and requirements in different countries, industries, and policy contexts.

**International scenario**

**Australia**

Australia's major financial services regulators of deposits, insurance, and superannuation include the Reserve Bank of Australia (RBA), the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investments Commission (ASIC), and the Australian Competition and Consumer Commission (ACCC). These regulators help to ensure financial institutes meet their promises, that transactional information is well documented, and that competition is fair while protecting consumers. The APRA in particular deals with superannuation and its regulation, including new regulations requiring trustees of superannuation funds to demonstrate to APRA that they have adequate resources (human, technology and financial), risk management systems, and appropriate skills and expertise to manage the superannuation fund, with individuals running them being "fit and proper."

Other key regulators in Australia include the Clean Energy Regulator for "monitoring, facilitating and enforcing compliance with" energy and carbon emission schemes; and the Therapeutic Goods Administration for drugs, devices, and biologics.

Australian organizations seeking to remain compliant with various regulations may turn to AS ISO 19600:2015(which supersedes AS 3806-2006). This standard helps organizations with compliance management, placing "emphasis on the organisational elements that are required to support compliance" while also recognizing the need for continual improvement.

**Canada**

In Canada, federal regulation of deposits, insurance, and superannuation is governed by two independent bodies: the OSFI through the Bank Act, and FINTRAC, mandated by the Proceeds of Crime (Money Laundering) and Terrorist Financing Act, 2001 (PCMLTFA). These groups protect consumers, regulate how risk is controlled and managed, and investigate illegal action such as money laundering and terrorist financing.

Unlike any other major federation, Canada does not have a securities regulatory authority at the federal
government level. The provincial and territorial regulators work together to coordinate and harmonize regulation of the Canadian capital markets through the Canadian Securities Administrators (CSA).

**United Kingdom**

There is considerable regulation in the United Kingdom, some of which is from European Union legislation. Various areas are policed by different bodies, such as the Financial Conduct Authority (FCA), Environment Agency, Scottish Environment Protection Agency, Information Commissioner's Office, Care Quality Commission, and others.

Important compliance issues for all organizations large and small include the Data Protection Act 1998 and, for the public sector, Freedom of Information Act 2000.

The U.K. Corporate Governance Code (formerly the Combined Code) is issued by the Financial Reporting Council (FRC) and "sets standards of good practice in relation to board leadership and effectiveness, remuneration, accountability, and relations with shareholders. All companies with a Premium Listing of equity shares in the U.K. are required under the Listing Rules to report on how they have applied the Combined Code in their annual report and accounts.

It is also possible that shareholders may not understand the figures as presented in the various financial statements, hence it is critical that the board should provide notes on accounting policies as well as other explanatory notes to help them understand the report better.

**United States**

Corporate scandals and breakdowns such as the Enron case of reputational risk in 2001 have increased calls for stronger compliance and regulations, particularly for publicly listed companies. The most significant regulation in this context is the Sarbanes–Oxley Act which defined significantly tighter personal responsibility of corporate top management for the accuracy of reported financial statements; and the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The Office of Foreign Assets Control (OFAC) is an agency of the United States Department of the Treasury under the auspices of the Under Secretary of the Treasury for Terrorism and Financial Intelligence. OFAC administers and enforces economic and trade sanctions based on U.S. foreign policy and national security goals against targeted foreign states, organizations, and individuals.

Compliance in the U.S. generally means compliance with laws and regulations. These laws can have criminal or civil penalties or can be regulations. On October 12, 2006, the U.S. Small Business Administration re-launched Business.gov (new Business.USA.gov) which provides a single point of access to government services and information that help businesses comply with government regulations.

The U.S. Department of Labor, Occupational Health and Safety Administration (OSHA) was created to assure safe and healthful working conditions for working men and women by setting and enforcing standards and by providing training, outreach, education and assistance. OSHA implements laws and regulations regularly in the following areas, construction, maritime, agriculture, and recordkeeping.

The International Organization for Standardization (ISO) and its ISO 19600 standard is one of the primary international standards for how businesses handle regulatory compliance, providing a reminder of how compliance and risk should operate together, as “colleagues” sharing a common framework with some nuances to account for their differences. The ISO also produces international standards such as ISO/IEC 27002 to help organizations meet regulatory compliance with their security management and assurance best practices.
India

In India, compliance regulation takes place across three strata: Central, State, and Local regulation. India veers towards central regulation, especially of financial organizations and foreign funds. Compliance regulations vary based on the industry segment in addition to the geographical mix. Most regulation comes in the following broad categories: economic regulation, regulation in the public interest, and environmental regulation. India has also been characterized by poor compliance - reports suggest that only around 65% of companies are fully compliant to norms.

B. Corporate Compliance

A corporate compliance program is generally defined as a formal program specifying an organization’s policies, procedures, and actions within a process to help prevent and detect violations of laws and regulations. It goes beyond a corporate code-of-conduct since it is an operational program, not simply a code of expected ethical behavior. Clearly, a code-of-conduct is an important component of a compliance program and ethics remains the heart and soul of all corporate compliance programs.

However, a comprehensive program goes further by applying the code to the specific risks of an organization and integrating measures to address those risks. A more integrated approach also focuses on legal as well as internal compliance to mitigate the risks of fraud, as well as to reach strategic, operational, and financial reporting objectives. A corporate compliance program is a magnet that brings all of a company’s compliance efforts together. It is essentially a codification of applicable regulatory and internal compliance requirements, as well as a roadmap to action. A comprehensive program helps position a company to divert disasters, meet objectives, and grow shareholder value.

Checklist to be followed for setting up a good compliance program:

(a) **Understand the Scope:** Identify all regulatory and internal compliance needs and efforts to challenge if organizational responsibilities are properly aligned. This should not be a “one and done” step, but rather performed periodically as regulatory landscapes and operational environments are typically changing.

(b) **Gather Internal and External Intelligence:** Tap the collective intelligence of the company by soliciting thoughts from the Board, management and employees. Also look beyond the walls of the organization to understand industry developments and competitor reactions to corporate compliance. This includes researching legal actions to help identify risks.

(c) **Define Objectives:** Define objectives from an enterprise and business unit standpoints. This should be a significant part of the periodic strategic planning process.

(d) **Conduct a Risk Assessment:** Identify risks, probabilities, and the significance in terms of both qualitative and quantitative measures. Consider scenarios from a cause-and-effect standpoint.

(e) **Align Controls:** Policies, procedures, and actions within a process, should be in place to address the risks to best achieve objectives.

(f) **Verify /Buy-In and Understandability:** Everyone needs to know their roles. For control owners to be expected to act appropriately, they need to understand the “why” and “how” of the compliance program. Controls need to be clearly communicated, ideally with a feedback loop so control owners can voice their insights and concerns.

(g) **Test Cultural Support:** Many organizations have put in place paper programs that have no real
effect on the operations of the organization. Determine if the cultures at headquarters and all relevant business units are supportive of a strong corporate compliance program. This can be accomplished through surveys, independent reviews and entity-level control assessments.

(h) **Assess On-Going Compliance**: Build monitoring, internal audit and special reviews into the compliance program to help ensure that controls are operating effectively. This effort should also seek to identify the most-efficient alignment of responsibilities and controls.

(i) **Train, Educate and Communicate**: Deliver periodic targeted training and share compliance information with the business units, global functions, external partners, customers, vendors, and other stakeholder groups.

(j) **Measure Results and Report to Board**: Develop a reporting dashboard to keep management groups and the Board aware of compliance measures, trends and developments. This should address both internal and external activities.

### C. Legal compliance

Legal compliance is the process or procedure to ensure that an organization follows relevant laws, regulations and business rules. The definition of legal compliance, especially in the context of corporate legal departments, has recently been expanded to include understanding and adhering to ethical codes within entire professions, as well.

There are two requirements for an enterprise to be compliant with the law, first its policies need to be consistent with the law. Second, its policies need to be complete with respect to the law. The role of legal compliance has also been expanded to include self-monitoring the non-governed behavior with industries and corporations that could lead to workplace indiscretions. It is important to keep in mind that if a strong legal governance component is in place, risk can be accurately assessed and the monitoring of legal compliance be carried out efficiently.

Companies are challenged to comply with laws and regulations while also increasing shareholder value and protecting their brand. These challenges are acute in highly regulated industries such as financial services, health care, and life sciences where the compliance agenda has evolved beyond mere compliance to include strategic issues such as:

- Predicting the impact of emerging regulations on strategic direction, business model and compliance/risk management processes and systems
- Determining the right compliance roles and accountabilities between legal, compliance, audit and business functions
- Driving compliance culture change across diverse geographies, functions and teams
- Defining and measuring Compliance value and managing performance expectations
- Managing through crisis and remediation in more complex and diverse environments
- Developing integrated compliance capabilities to better anticipate global trends, increase efficiency, and participate in the evolution of the company’s core strategies

Thus legal compliance is a must and if the company has entered into formal contracts with customers, the clauses of those contracts also become legal requirements. Without adherence to the letter of the law, the corporates face costly litigation and the potential of untold damage to the business and its reputation.
CORPORATE COMPLIANCE MANAGEMENT

Corporate compliance management involves a full process of research and analysis as well as investigation and evaluation. Such an exercise is undertaken in order to determine the potential issues and get a realistic view about how the entity is performing and how it is likely to perform in the future. Company Secretaries with core competence in compliance and corporate governance play a crucial role in the corporate compliance management.

This focused attention on compliances with spirit and details of laws casts upon Company Secretaries an onerous responsibility to guide the corporates adapting with compliance regimes, so as to ensure extended protection to investors, shareholders and other stakeholders. They have to advise companies in totality to provide full, timely and intelligible information. To enable companies to put in place an effective Compliance Management System, company secretaries should ensure that companies:

- adhere to necessary industry and government regulations,
- Change business processes according to legislative change,
- Realign resources to meet compliance deadlines,
- React quickly and cost-effectively if regulations change.

SIGNIFICANCE OF CORPORATE COMPLIANCE MANAGEMENT

1. Better compliance of the law
2. Real time status of legal/statutory compliances
3. Safety valve against unintended non compliances/ prosecutions, etc.
4. Real time status on the progress of pending litigation before the judicial/quasi-judicial fora
5. Cost savings by avoiding penalties/fines and minimizing litigation
6. Better brand image and positioning of the company in the market
7. Enhanced credibility/creditworthiness that only a law abiding company can command
8. Goodwill among the shareholders, investors, and stakeholders.
9. Recognition as Good corporate citizen.

Compliance with the requirements of law through a compliance management programme can produce positive results at several levels:

- Companies that go the extra mile with their compliance programs lay the foundation for the control environment.
- Companies with effective compliance management programme are more likely to avoid stiff personal penalties, both monetary and imprisonment.
- Companies that embed positive ethics and effective compliance management programme deep within their culture often enjoy healthy returns through employee and customer loyalty and public respect for their brand, both of which can translate into stronger market capitalization and shareholder returns.

Clearly, the benefits of implementing and maintaining an effective ethics and compliance program far outweigh its costs. Not only does the compliance management protect investors wealth but also helps the
business in running successfully with any potential risk being addressed in a timely and accurate manner.

Since 1991, in USA, the companies that create, communicate, enforce, and promote effective compliance programs, as defined by the U.S. Federal Sentencing Guidelines for Organizations, have been given favorable treatment by the Department of Justice, even when misconduct by employees in their organizations has been proven. The resultant savings, in terms of mitigated fines, has totaled hundreds of millions of dollars.

Corporate Compliance Management can add substantial business value only if compliance is done with due diligence. A Company Secretary is the ‘Compliance Manager’ of the company. It is he who ensures that the company is in total compliance with all regulatory provisions. Corporate disclosures, which play a vital role in enhancing corporate valuation, is the forte of a Company Secretary. These disclosures can be classified into statutory disclosures, non-statutory disclosures, specifies disclosures and continuous disclosures.

Secretarial Audit: As per section 204(1) of Companies Act, 2013 read with rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, certain companies are required to obtain Secretarial Audit Report from the company Secretary in Practice. According to these provisions every listed company, every public company having a paid-up share capital of fifty crore rupees or more; or every public company having a turnover of two hundred fifty crore rupees or more are required to obtain Secretarial Audit Report.

In terms of Form MR-3 the secretarial auditor needs to examine and report on the compliance of the following five specific laws:

(i) The Companies Act, 2013 (the Act) and the rules made thereunder;
(ii) The Securities Contracts (Regulation) Act, 1956 (“SCRA”) and the rules made thereunder;
(iii) The Depositories Act, 1996 and the Regulations and Bye laws framed thereunder;
(iv) Foreign Exchange Management Act, 1999 and the rules and regulations made thereunder to the extent of Foreign Direct Investment, Overseas Direct Investment and External Commercial Borrowings;
(v) The following Regulations and Guidelines prescribed under the Securities and Exchange Board of India Act, 1992 (‘SEBI Act”):-
(a) The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;
(b) The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992;
(c) The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
(d) The Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999;
(e) The Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008;
(f) The Securities and Exchange Board of India (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 regarding the Companies Act and dealing with clients;
(g) The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009; and
(h) The Securities and Exchange Board of India (Buyback of Securities) Regulations, 1998;

In addition, the form MR-3, point (vi) also refers to “Other laws as may be applicable specifically to the company.

Thus, for certain specified companies, not even the compliance of the Company Law but all the laws applicable to the specific company are to be adhered to.

Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 spells out elaborately on various aspects of disclosures which are to be made by the company. A Company Secretary has to ensure that these disclosures are made to shareholders and other stakeholders in true letter and spirit.

In nutshell, the Company Secretary is the professional who guides the Board and the company in all matters, renders advice in terms of compliance and ensures that the Board procedures are duly followed, best global practices are brought in and the organisation is taken forward towards good corporate citizenship.

COMPLIANCE RISK

Every organisation has a responsibility to identify existing and emerging legislation relevant to its business and ensure that risks that may arise from the compliance requirements are well understood by the board and management. The risks that may stem from non-compliance with key legislative requirements can be very costly and damaging to an organisation and the custodians of governance within the organisation.

Even small businesses, non-profits, and government agencies are facing issues that only large companies had to face in the past such as:

- Stakeholders demand high performance along with high levels of transparency
- Regulations and enforcement are ever-changing and unpredictable
- Exponential growth of third-party relationships and risk is a management challenge
- The costs of addressing risks and requirements are spinning out of control
- The harsh (and scary) impact when threats and opportunities are not identified

The consequences of non-compliance range from penalties and fines, to imprisonment, withdrawal of licenses, lawsuits and reputational risk which may individually and or collectively have a fundamental impact on the organisation’s sustainability as a going concern; as well as the impact that a lack of good corporate governance at board and business levels can have on the business. The impact and probability of the risks that the legislation represents depend on the attention paid to the legislation and how well risk and compliance management is entrenched within the organisation. It is therefore critical that an organisation implements relevant structures and processes to effectively manage and monitor the compliance process to ensure that these are entrenched in a way that compliance becomes “second nature”. The residual risk will also be high until the organisation is able to implement measures or controls that effectively mitigate the new risks arising out of compliance requirements for the new legislation.

Compliance risk is exposure to legal penalties, financial forfeiture and material loss an organization faces when it fails to act in accordance with industry laws and regulations, internal policies or prescribed best practices.

Compliance risk is also sometimes known as integrity risk. Many compliance regulations are enacted to ensure that organizations operate fairly and ethically. For that reason, compliance risk is also known as
integrity risk.

Compliance Risk management is part of the collective governance, risk management and compliance (GRC) discipline. The three fields frequently overlap in the areas of incident management, internal auditing, operational risk assessment, and compliance with various regulations.

Penalties for compliance violations include payments for damages, fines and avoided contracts, which can lead to the organization's loss of reputation and business opportunities, as well as the devaluation of its franchises.

The following are a few examples of compliance risks.

1. **Environmental Risk**

   Potential for damage to living organisms or the environment arising out of an organization's activities.

2. **Workplace Health & Safety**

   Risks related to all aspects of health and safety in the workplace such as accidents or repetitive strain injuries.

3. **Corrupt Practices**

   The potential for corrupt practices such as bribery or fraud. Organizations are generally responsible for the actions of their employees and agents in this regard.

4. **Social Responsibility**

   The risk that the business activities will harm the workers or the people in the communities in which they operate.

5. **Quality**

   Releasing a low quality product or service that fails to meet the expected level of due diligence in the industry or that violates laws and regulations.

6. **Process Risk**

   The risk that the processes will fail resulting in legal violations such as failure to meet the responsibilities to the customers or partners. Process failures can also result in reporting or accounting errors that breach the duties to the investors.

### CONSEQUENCES OF NON-COMPLIANCE

Failing to comply with rules, regulations, and specifications could have costly consequences. The infamous Walmart Photo Center Data breach in which hackers filched customers’ credit card details was settled recently. The company was obliged to pay $450 million in compensation to clients hand over affected accounts for monitoring at the cost of $350 million and pay $500 million in plaintiff’s legal fees. The court found that the company was aware of compliance requirements, but failed to implement them or enforce them.

Thus non-compliance with the laws of the land can have multi-faceted consequences, ranging from penalties, additional fines to prosecution. Following are some of the brief consequences to give a general idea:
(i) Roadblock in Funding

The pre-requisite of any funding exercise is the status of tax and regulatory compliances. Never has a company got funded, even in the seed investment level, whose compliances are not up-to-date. Non-compliant startups do not even live through the term sheet stage. Further, there is a severe negative marking for compliances done post due date with additional fees.

(ii) Roadblock in availability of Bank loan

External angel/venture funding being out of question, next source of funding for any business is bank loan. However, even banks require compliance documents like audited financials, auditor’s report, auditor’s certificate for the last 3 years or as the case may be. Chances of a non-compliant company availing bank loans are next to zero per cent.

(iii) Roadblock in availability of Govt. Tenders

The pre-requisite of any such tender is a compliant business environment, where all reporting is up-to date.

(iv) Stamp of a “Dormant” Company

Companies with a non-filing history of 3 years or more are often categorized by the Ministry as ‘dormant’ companies. These companies can never be eligible for any sort of Govt/institutional assistances/contracts. Apart from that, these companies are vulnerable to RoC demand notices technically at any time.

(v) Liability of Directors

Simply closing down the inactive company or starting up a totally new company does not solve the problem. A director of a company which has not filed its returns for 3 consecutive years is disqualified to become a director in any other company as per the Companies Act, 2013. In other words, his DIN gets blocked and he would not be able to start a new company.

(vi) General Penalties-

a) Penalty for Non- Preparation of Financial Statements –

It is punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than Rs. 50,000 but which may extend to Rs. 500,000 or both.

b) Penalty for Non- filing of Income Tax Return Filing–

It will attract interest u/s 234A and i.e. if the assessee fails to file its income tax return within the time prescribed by section 139, the he shall be liable to pay interest @ 1% per month or part of the month from the due date of filing of return to the actual date of filing of its return. A further penalty can be levied up to Rs. 5,000 for non-filing of tax returns us 271F.

c) Penalty for Non-filing of Annual RoC forms–

Additional fee leviable as per specified MCA slabs, which may extend upto 12 times of original fees. Apart from this, provisions for striking off the company and prosecution are also present.

d) Penalty for Non-filing of Annual RoC forms–

Additional fee leviable as per specified MCA slabs, which may extend upto 12 times of original fees. Apart from this, provisions for striking off the company and prosecution are also present.
e) Miscellaneous:
   1. Cessation of business activities
   2. Civil action by the authorities
   3. Punitive action resulting in fines against the company/officials
   4. Imprisonment of the errant officials
   5. Public embarrassment
   6. Damage to the reputation of the company and its employees
   7. Plummetsing stock price and threat of de-listing of shares (in case of listed companies)
   8. Attachment of bank accounts.

<table>
<thead>
<tr>
<th>Compliance area (illustrative)</th>
<th>Possible risk of non compliance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct tax compliance</td>
<td>Impostion of penalty</td>
</tr>
<tr>
<td></td>
<td>Prosecution of directors</td>
</tr>
<tr>
<td></td>
<td>Loss of reputation</td>
</tr>
<tr>
<td>Indirect tax compliance</td>
<td>Cancellation of licences</td>
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<tr>
<td></td>
<td>Withdrawal of tax benefits</td>
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<tr>
<td></td>
<td>Stoppage of operations</td>
</tr>
<tr>
<td></td>
<td>Loss of reputation</td>
</tr>
<tr>
<td>Labour law compliance</td>
<td>Impostion of penalty</td>
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<tr>
<td></td>
<td>Prosecution of directors / occupier</td>
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<td></td>
<td>Loss of reputation</td>
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<td></td>
<td>Employee dissatisfaction</td>
</tr>
<tr>
<td>Environment, health &amp; safety laws</td>
<td>Stoppage of operations</td>
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<td></td>
<td>Loss of reputation</td>
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<td></td>
<td>Imposition of penalty</td>
</tr>
<tr>
<td>Corporate law compliance</td>
<td>Impostion of penalty</td>
</tr>
<tr>
<td></td>
<td>Vacation / prosecution of directors / senior management</td>
</tr>
<tr>
<td></td>
<td>Loss of reputation</td>
</tr>
</tbody>
</table>

Challenges for Effective Corporate Compliance management

1. Large number of legislations and multiple regulators
2. Multiple business locations attracting state legislations
3. Lack of ownership /awareness of functional staff about compliance requirements
4. Segmented compliance initiatives
5. Time-consuming and unreliable manual reporting
6. Dynamic legal environment, lack of a robust updation process, frequent changes in process owners and internal processes.

**MANAGING COMPLIANCE RISK**

In today’s environment of global regulatory convergence, ever-increasing complexity, and the expansion of businesses into new or adjacent industries, the need for a broader view of compliance risk has never been greater. Nevertheless, according to a survey conducted jointly by Deloitte and Compliance Week, 140 percent of companies do not perform an annual compliance risk assessment.

New ethics, compliance, and reputational risks appear each day. At the same time, the recent global recession has forced many organizational functions to closely examine their budgets and resources. Together, these factors have created a tension between growing regulatory obligations and the pressure to do more with less. To help resolve this situation and continue to add value to their organizations, ethics and compliance professionals need to be sure they understand the full spectrum of compliance risks lurking in each part of the organization. They then need to assess which risks have the greatest potential for legal, financial, operational, or reputational damage and allocate limited resources to mitigate those risks.

<table>
<thead>
<tr>
<th>Rating</th>
<th>Reputational fallout/Brand damage</th>
<th>Civil or criminal fines or penalties</th>
<th>Loss of sales/customer confidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>HIGH</td>
<td>Sustained national (and international) negative media coverage (front page of business section)</td>
<td>Major Government or state action/ Fraud or bribery investigation</td>
<td>Significant loss or harm of customer relationship(s), including customer shut downs</td>
</tr>
<tr>
<td>LOW</td>
<td>Negative U.S. national or international media coverage (not front page)</td>
<td>Government or state investigations</td>
<td>Failure of ability to meet customer needs, e.g., significant quality issues, customer delays, or inability to deliver products to customer</td>
</tr>
<tr>
<td></td>
<td>Negative media coverage in a specific U.S. region or a foreign country</td>
<td>Routine costly litigation</td>
<td>Ineffective products delivered to customers or delay in customer delivery</td>
</tr>
<tr>
<td>Localized negative impact on reputation (such as a single large customer) but recoverable</td>
<td>Smaller actions, penalties/fines</td>
<td>Less than optimal acceptance by customers</td>
<td></td>
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<td>---</td>
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<td>---</td>
<td></td>
</tr>
<tr>
<td>No press exposure</td>
<td>No regulatory or legal action</td>
<td>Limited, if any, impact on customers</td>
<td></td>
</tr>
</tbody>
</table>

By combining corporate governance and risk management, the organisation could gain a competitive advantage, and create, protect, and enhance its shareholder value. In fact, a good corporate governance practice is a key determinant of investor’s investment. This view is supported by a key finding in the survey of corporate governance, conducted by the Kuala Lumpur Stock Exchange (KLSE) and Price Water House Coopers (2002) on the local and foreign asset management firms, security research firms, security dealers and brokers, insurance companies, and local unit trusts. The survey revealed that if further improvements were to be made to strengthen corporate governance, it would encourage them (respondents) to invest in Malaysia. This could indirectly increase the firm’s value.

There are a number of critical questions organizations should ask related to compliance risks and the program(s) in place to mitigate those risks:

- What kinds of compliance failures would create significant brand risk or reputational damage? Could the failures arise internally, in the supply chain, or with regard to third parties operating on the organization’s behalf?
- What is the likely impact of that damage on the organization’s market value, sales, profit, customer loyalty, or ability to operate?
- What kinds of compliance missteps could cause the organization to lose the ability to sell or deliver products/services for a period of time?
- How should the compliance program design, technology, processes, and resource requirements change in light of growth plans, acquisitions, or product/category/service expansions?
- Is the organization doing enough to inform customers, investors, third parties, and other stakeholders about its vision and values? Is it making the most of ethics, compliance, and risk management investments as potential competitive differentiators?
- What are the total compliance costs—beyond salaries and benefits at the centralized level—and how are costs aligned with the most significant compliance risks that could impact the brand or result in significant fines, penalties, and/or litigation?
- How well-positioned is the compliance function? Does it have a seat “at the table” in assessing and influencing strategic decisions?
- What are the personal and professional exposures of executive management and the board of directors with respect to compliance?

While it is impossible to eliminate all of an organization’s risk exposure, the risk framework and methodology help the organization prioritize which risks it wants to more actively manage. Developing a framework and methodology helps organizations determine the extent to which the organization’s existing risk-mitigation activities (for example, testing and monitoring or employee training programs) are able to reduce risk.
Effective risk mitigation activities may reduce the likelihood of the risk event occurring, as well as the potential severity of impact to the organization. When an organization evaluates inherent risk in light of its existing control environment and activities, the degree of risk that results is known as the “residual risk.” If existing risk mitigation strategies are insufficient at reducing residual risk to an acceptable level, this is an indication that additional measures are in order.

Embedding compliance with all key legislation in the organisation is a function of certain critical activities and stems from collaboration across key functions such as Legal, Compliance, Risk Management, Business and Internal Audit. These functions all form part of the “three lines of defence”. The success of any compliance management and monitoring programme depends on the existence, functioning and integration of these lines of defence in the performance of their duties.

**Management Assurance**

- Assists in setting and executing strategies.
- Provides direction, guidance and oversight
- Promotes a strong risk culture & sustainable risk return thinking
- Promotes a strong compliance culture and management of risk exposure.
- Ongoing monitoring and management of risks.

**Risk Management, Legal & Compliance**

- Formal, robust and effective risk management within which the organisation’s policies and minimum standards are set.
- Objective oversight and the ongoing challenge of risk mitigation, management and performance while reporting is achieved across the business units.
- Overarching risk oversight across all risk types.
- The Legal and/or Compliance function should undertake the following:
  - Compile and maintain a legislative universe for the organisation.
  - Facilitate the risk prioritisation of all pieces of legislation in the regulatory universe. This should be done working together with the Risk Management division and using the organisation’s risk management framework.
  - Initiate new legislative requirements within the organisation. Review the legislation to confirm whether it affects the organisation, and how.
  - Analyse and send out alerts on the new law to inform the organisation of the new requirements.
  - Facilitate an executive review of the legislation by Legal analysts.
  - Facilitate the completion of the Compliance Risk Management Plan (“CRMP”) – Interpret key legislation in plain language on the CRMP and ensure the identification of issues, controls, risk exposure, responsible parties and monitoring plans by other participating parties such as Business and Internal Audit.
  - Update compliance monitoring plans on the CRMP.
• Escalate compliance matters to management.
• Undertake quarterly compliance reporting.

Internal Audit & other Independent Assurance Providers

• Independent and objective assurance of overall adequacy and effectiveness of governance, risk management and internal controls within the organisation

• Ability to link business risks with established processes and provide assurance on the effectiveness of mitigation plans to effectively manage organisational risks.

The Risk Management function should support the Compliance Office with the risk rating of the relevant legislation once such legislation becomes operational in the business. A compliance risk register for the regulatory universe, showing both the inherent and residual ratings of each piece of legislation, based on impact and likelihood, should be the product of this process. The penalties - financial, imprisonment, etc - and other business risks associated with key provisions of the legislation should be identified and captured on the compliance risk register for the regulatory universe as management should know if a piece of legislation will affect shareholder value.

Business should also have its own Business Operational Compliance Officer / Champion who, upon receipt from the Legal / Compliance Officer, the information containing the executive review, compliance alert, CRMP and presentation material, will commence the operational monitoring of the compliance of business processes to the legislative requirements. Again, depending on the size and maturity of the organization, the roles of Legal / Compliance Officer can be combined with that of the Business Operational Compliance Officer, even that of the Risk Officer. This, of course, should be with due consideration of the nature and magnitude of business operations, the risk profiles as well as the cost and benefits of combining or separating the functions. Business should readily be able to provide Internal Audit with the legislative universe of the organisation for the commencement of a compliance audit.

Internal Audit, as the assurance provider, is responsible for reviewing the adequacy and effectiveness of the functioning of controls implemented by management to ensure compliance with legislative requirements.

In conducting a review of compliance within the organisation, Internal Audit should ask the following questions:

• What are the pieces of legislation that should be reviewed?
• What new processes are being put in place as a result of compliance requirements?
• What new systems are being put in place to support and monitor compliance?

The span of the internal audit review will be: Legislation – Policy – Procedures – Systems / Processes.

Internal Auditors should be able to map the legislation to the existence of a policy and a risk map. They need to substantiate and audit compliance risk ratings that have changed, especially where residual ratings show improved controls. For example, if the organisation has had many complaints escalated to an ombudsman, it is a likely indication of non-compliance and hence the applicable residual rating cannot be acceptable (green); it should probably be yellow or red.

From their review, Internal Auditors should be able to validate or provide the following inputs to the CRMP:

• Impacted Areas – processes, systems and policies
• Existing Controls
• Additional Controls – arising from amendments to, or new legislation
• Risk Exposure – High, Medium, Low
• Responsible Party – Affected Parties
• Monitoring Plan – Business Unit Compliance

Thus the compliance framework needs to be comprehensive, dynamic, and customizable, allowing the organization to identify and assess the categories of compliance risk to which it may be exposed. Some compliance risks are specific to an industry or organization—for example, worker safety regulations for manufacturers or rules governing the behavior of sales representatives in the pharmaceutical industry. Other compliance risks transcend industries or geographies, such as conflicts of interest, harassment, privacy, and document retention.

Thus a successful compliance-risk management program which is an essential for sound and vibrant operational system contains the following elements:

**Active board and senior management oversight:** An effective board and senior management oversight is the cornerstone of an effective compliance risk management process.

**Effective policies and procedures:** Compliance risk management policies and procedures should be clearly defined and consistent with the nature and complexity of an institution’s activities.

**Compliance risk analysis and comprehensive controls:** Organizations should use appropriate tools in compliance risk analysis like self-assessment, risk maps, process flows, key indicators and audit reports; which enables establishing an effective system of internal controls.

**Effective compliance monitoring and reporting:** Organizations should ensure that they have adequate management information systems that provide management with timely reports on compliance like training, effective complaint system and certifications.

**Testing:** Independent testing should be conducted to verify that compliance-risk mitigation activities are in place and functioning as intended throughout the organization.

Some industries are more highly regulated, and as a result face greater external compliance risk. All companies also face internal compliance risk, which means complying with their own internal policies and procedures. The key to managing these risks is installing controls that confirm the organization is complying with its internal and external requirements on a consistent and regular basis.

**NEW DEVELOPMENTS- GOVERNANCE AND RISK COMPLIANCE (GRC)**

As the world becomes more complex, enterprises need a range of GRC skills and capabilities that may not all be present with a single provider or a single business function. Some may lie with a consulting firm, others with a data or content firm, and still others with a technology platform provider or a system integrator. Going forward, the emphasis will be on how we can bring more of these companies and their capabilities together in a single, comprehensive GRC community – one that fosters open and transparent communication, and enables people to learn from each other’s best practices and mistakes.

GRC professionals are increasingly being given a seat at the company strategy table, the revenue generating side. Decision-makers need them to interpret risk profiles and data, and provide intelligence on how to increase revenue and sales.
Soon, operating controls will not only help mitigate operational risk, but also enable faster go-to-market opportunities. Similarly, vendor risk management won’t just be about calculating vendor risks, but also tying those metrics to vendor performance and charge backs. The emphasis, more and more, will be on linking GRC to business performance.

CONCLUSION

Good governance and compliance practices are not an endpoint, but a path towards creating a corporate environment of trust, transparency, and accountability. This in turn promotes corporate access to capital, increased investment, sustainable growth and financial stability. Making this system work effectively and efficiently requires flexible, principles-based approaches as well as buy-in and participation from all financial reporting supply chain participants. Rules-based, prescriptive approaches that assume that one size can fit all, are just not appropriate in today’s highly globalized and complex business environment in which success or failure hinge on the ability to adapt business models and forms of capital to continuously evolving economic realities.

The complexity of the risk landscape and the penalties for non-compliance make it essential for organizations to conduct thorough assessments of their compliance risk exposure. This is particularly true for those organizations that operate on a global scale.

A good ethics and compliance risk assessment includes both a comprehensive framework and a methodology for evaluating and prioritizing risk. With this information in hand, organizations will be able to develop effective mitigation strategies and reduce the likelihood of a major noncompliance event or ethics failure, setting themselves apart in the marketplace from their competitors.

Thus, policy-makers best serve the public interest when they allow for flexibility in setting corporate governance rules. Companies also have a responsibility to establish a corporate culture and tone at the top that promote a values-based rather than compliance-based mindset to governance. Management, internal auditors, boards of directors and external auditors share the responsibility of executing their respective roles with healthy skepticism, transparency and robust communication.

GLOSSARY OF TECHNICAL WORDS

- **Corporate Compliance**: A corporate compliance program is generally defined as a formal program specifying an organization’s policies, procedures, and actions within a process to help prevent and detect violations of laws and regulations.

- **Risk Assessment**: It’s a systematic process of evaluating the potential risks that may be involved in a projected activity or undertaking.

- **Corporate Citizen**: Corporate citizenship involves the social responsibility of businesses, and the extent to which they meet legal, ethical and economic responsibilities, as established by shareholders.

- **Compliance Risk**: Compliance risk is exposure to legal penalties, financial forfeiture and material loss an organization faces when it fails to act in accordance with industry laws and regulations, internal policies or prescribed best practices.

- **Internal Audit**: Internal audit is a dynamic profession involved in helping organisations achieve their objectives. It is concerned with evaluating and improving the effectiveness of risk management, control and governance processes in an organisation.
Lesson Round Up

- Compliance function checks that all relevant laws are being properly complied with by the organisation.
- Compliant organizations need an effective approach to verify that they are in conformity with external standards/regulations and internal policies/rules. This approach is assisted by risk management, which must identify and prioritize risks that are already aligned with corporate objectives defined by governance.
- Conformance applies to strategies and plans that are adopted to be more productive or to improve quality.
- The risks that may stem from non-compliance with key legislative requirements can be very costly and damaging to an organisation.
- The key to managing these risks is installing controls that confirm the organization is complying with its internal and external requirements on a consistent and regular basis.
- A compliance management system is the method by which corporate manage the entire compliance process. It includes the compliance program, compliance audit, compliance report etc.
- The Company Secretary is the professional who guides the Board and the company in all matters, renders advice in terms of compliance and ensures that the Board procedures are duly followed, best global practices are brought in and the organisation is taken forward towards good corporate citizenship.
- Compliances, good governance and risk management in turn promotes corporate access to capital, increased investment, sustainable growth and financial stability.

Self Test Questions

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Define Compliance. State briefly the need of compliance in the emerging scenario.
2. How is compliance different from conformance?
3. What is compliance risk? State the different types of compliance risks.
4. Explain the consequences of non-compliance.
5. What are the challenges for effective corporate management?
Lesson 9
Corporate Governance Forums

LESSON OUTLINE

• Introduction
• The Institute of Company Secretaries of India
• National Foundation for Corporate Governance
• Organisation for Economic Co-operation and Development
• Institute of Directors, UK
• Commonwealth Association of Corporate Governance
• International Corporate Governance Network
• European Corporate Governance Institute
• Conference Board
• Asian Corporate Governance Association
• Corporate Secretaries International Association
• Parameters of Better Governed Companies
• Glossary
• LESSON ROUND UP
• SELF TEST QUESTIONS
• Reference for Further Reading

LEARNING OBJECTIVES

The objective of this study lesson is to enable the students gain knowledge about the forums which are active in promoting the culture of creativity and compliance among corporate. The vision/mission/ objective of the corporate governance forum is discussed in the chapter to provide student an understanding of the purpose of forming such governance forum and their role in improving the corporate governance.

“You have to test your ideas in a public forum”

Hillary Clinton
INTRODUCTION

The world has become a borderless global village. The spirit to implement internationally accepted norms of corporate governance standards found expression in private sector, public sector and the government thinking. The framework for corporate governance is not only an important component affecting the long-term prosperity of companies, but it is critical in terms of National Governance, Human Governance, Societal Governance, Economic Governance and Political Governance since the activities of the corporate have an impact on every aspect of the society as such.

The need to find an institutional framework for corporate governance and to advocate its cause has resulted in the setting up and constitution of various corporate governance forums and institutions the world over. In this study lesson we will be discussing with some of the prominent Forums and Institutions of Corporate Governance.

In the words of Mr. N.R. Narayana Murthy, Chief Mentor, Infosys Limited, “Corporate governance is maximizing the shareholder value in a corporation while ensuring fairness to all stakeholders, customers, employees, investors, vendors, the government and the society-at-large. Corporate governance is about transparency and raising the trust and confidence of stakeholders in the way the company is run. It is about owners and the managers operating as the trustees on behalf of every shareholder - large or small.”

A. INSTITUTE OF COMPANY SECRETARIES OF INDIA (ICSI)

Vision and Mission Statements

Recognising the fact that Corporate Governance is the key to development of corporate sector, the Institute has adopted a farsighted vision, “To be a global leader in promoting Good Corporate Governance”

The Mission of the Institute is, “To develop the high calibre professionals facilitating good Corporate Governance”.

ICSI’s Philosophy on Corporate Governance

The ICSI, after extensive research, has taken a lead step in defining Corporate Governance as “the application of best management practices, compliance of law in letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders.”

ICSI Initiatives

- **Corporate Governance Research and Training** - ICSI has set up the ICSI- Centre for Corporate Governance Research and Training (CCGRT) with the objective of fostering and nurturing research initiatives among members of the Company Secretaries profession and other researchers.

- **ICSI National Award for Excellence in Corporate Governance** was instituted by the ICSI in 2001 to identify, foster and reward the culture of evolving global best practices of corporate governance among Indian companies. Each year, the award is conferred upon two best governed companies and ICSI Life Time Achievement Award for Translating Excellence in Corporate Governance into Reality is bestowed on an eminent personality.

- **Focus on Corporate Governance in the Course Curriculum** - Considering corporate governance as core competency of Company Secretaries, education and training for Company Secretary significantly focuses on corporate governance. One full paper on Corporate Governance titled “Governance, Risk Management, Compliances and Ethics” forms part of the syllabus in the
Lesson 9 Corporate Governance Forums

Professional Programme.

► **PMQ Course in Corporate Governance** - ICSI has launched a Post Membership Qualification Course in Corporate Governance to enable its members gain acumen, insight and thorough expertise in corporate governance.

► **Secretarial Standards** - As a pioneering initiative, ICSI issues Secretarial Standards to integrate, harmonise and standardise the diverse secretarial practices prevalent in the corporate sector. Two Secretarial Standards issued by ICSI i.e. SS-1: Secretarial Standard on Meetings of the Board of Directors and SS-2: Secretarial Standard on General Meetings have been notified in the Official Gazette under Section 118 (10) of the Companies Act 2013 which provides that every company shall observe Secretarial Standards with respect to General and Board Meetings specified by the Institute of Company Secretaries of India and approved as such by the Central Government. They have been effective from July 1, 2015. The introduction of Secretarial Standard has marked a new era of healthy secretarial practices among professional.

► **Corporate Governance Publications** – The Institute regularly brings out publications of interest to members and corporate sector to inculcate the culture of good governance.

► **Directors Development and Capacity Building Programmes** - Recognizing that leadership development in boardroom is the key driver to better governance, the Institute organizes directors’ development programmes. The Institute also conducts extensive programmes throughout India and abroad strengthening specialization in corporate governance.

► **Investor Education and Awareness** - Committed to the cause of investor education, ICSI is actively engaged in activities relating to investor awareness and education. So far, the Institute has organised more than 4500 such programmes. Booklets to educate investors have also been issued by the Institute in English, Hindi as well as other regional languages.

► **ICSI Recommendations to Strengthen Corporate Governance Framework** - ICSI after a detailed study of corporate governance standards, principles and practices across the world, made its recommendations to strengthen the Corporate Governance Framework. Corporate Governance Voluntary Guidelines, 2009 issued by MCA draw substantially from the ICSI Recommendations to Strengthen the Corporate Governance Framework.

► **Repository of Independent Directors** - The Institute jointly with other professional statutory bodies under the active encouragement of the Ministry of Corporate Affairs, maintains a Repository of Independent Directors to facilitate the individuals who are eligible and willing to act as Independent Directors and also to facilitate Companies to select the persons who are eligible and willing to act as Independent Directors under provisions of the Companies Act, 2013.

► **National Policy on Corporate Governance** - The Ministry of Corporate Affairs had constituted a Committee to formulate a Policy Document on Corporate Governance under the chairmanship of Mr. Adi Godrej. The President, ICSI was the Member Secretary/Convener. The concept paper prepared by ICSI was the base paper for discussion for this committee. The Committee submitted its report, which is articulated in the form of Guiding Principles of Corporate Governance, to the Government of India on 18th September, 2012.

► **Customized Training Programme** - As an initiative towards propagating and creating awareness on good corporate governance, the Institute has been organising customised training programmes for Regulatory bodies, Banks and Public sector companies on Corporate Laws and Governance.

► **Founder member of National Foundation for Corporate Governance** - The ICSI is one of the
four founder trustees of National Foundation for Corporate Governance, alongwith MCA, CII and ICAI. The vision of NFCG is: Be A Catalyst In Making India The Best In Corporate Governance Practices.

- **Founder member of Corporate Secretaries International Association (CSIA)** - ICSI is a founder member of Corporate Secretaries International Association, alongwith the Chartered Secretaries Institutes of Australia, Hong Kong, Malaysia, Singapore, South Africa, UK and Zimbabwe. CSIA was launched in March 2010 and has issued ‘Twenty Practical Steps to Better Corporate Governance’.

- **Linkages of International Bodies** – The Institute has linkages with various International bodies involved in promoting Corporate Governance such as World Bank, Organisation for Economic Co-operation and Development (OECD), International Corporate Governance Network (ICGN), Global Corporate Governance Forum GCGF (IFC - Washington), Global Reporting Initiative (GRI), Asia Corporate governance Association (ACGA). The Institute also holds various Joint programmes with, these institutions and also with professional bodies like CASS Business School (London), ICSA Singapore, ICSA Malaysia, etc.

### ICSI’s Approach - Solution to Critical Development Issues

The ICSI's approach to Corporate Governance provides the solution to the development issues. Wealth creation, management and sharing are the objectives of Corporate Governance in broadest sense. Maximum creation and effective management of wealth requires application of best management practices whereas sharing of wealth requires compliance of law in letter and spirit along with adherence to ethical standards and discharging corporate social responsibility so as to develop trust amongst all the stakeholders.

- Members of ICSI are in prominent positions in the management of board affairs at high levels.

- Member of the institute are imparted wider knowledge of management functions, major laws applicable to a company as well as of good corporate governance practices and are subject to a strict **Professional Code of Conduct** under the Company Secretaries Act, 1980, so as to ensure ethics in dealing with all the stakeholders.

#### B. NATIONAL FOUNDATION FOR CORPORATE GOVERNANCE (NFCG)

With the goal of promoting better corporate governance practices in India, the Ministry of Corporate Affairs, Government of India, has set up National Foundation for Corporate Governance (NFCG) along with Confederation of Indian Industry (CII), Institute of Company Secretaries of India (ICSI) and Institute of Chartered Accountants of India (ICAI). In the year 2010, stakeholders in NFCG have been expanded with the inclusion of Institute of Cost Accountants of India and the National Stock Exchange of India Ltd.

**Vision**

- “Be the Key Facilitator and Reference Point for highest standards of Corporate Governance in India.”

**Mission of NFCG**

- To foster a culture for promoting good governance, voluntary compliance and facilitate effective participation of different stakeholders;
- To catalyse capacity building in new emerging areas of Corporate Governance.
- To further research, scholarship, and education in corporate governance in India;
To create a framework of best practices, structure, processes and ethics;

NFCG endeavours to build capabilities in the area of research in corporate governance and to disseminate quality and timely information to concerned stakeholders. It works to foster partnerships with national as well as international organisations.

National Foundation for Corporate Governance (NFCG) was set up in the year 2003 by the Ministry of Corporate Affairs (MCA), in partnership with Confederation of Indian Industry (CII), Institute of Company Secretaries of India (ICSI) and Institute of Chartered Accountants of India (ICAI) to promote good Corporate Governance practices both at the level of individual corporates and Industry as a whole. In the year 2010, Institute of Cost Accountants of India (ICAI) and National Stock Exchange (NSE) and in 2013 Indian Institute of Corporate Affairs (IICA) were included in NFCG as Trustees.

At the national level, NFCG works with premier management institutes as well as nationally reputed professional organisations to design and administer Directors Training Programmes. The Foundation provides accreditation to these organisations based on their meeting the eligibility criteria designed along with continuing adherence to the same. On obtaining the accreditation these organisations, with the support of NFCG, would set-up a "National Center for Corporate Governance (NCCG)" to provide a training to Directors, conduct research and build capability in the area of corporate governance.

NFCG also would work to have arrangements with globally reputed organisations with the aim of promoting bilateral initiatives to improve regulatory framework and practices of corporate governance in a concerted and coordinated manner.

The internal governance structure of NFCG consists:

- Governing Council
- Board of Trustees
- Executive Directorate

(i) Governing Council

Governing Council of NFCG works at the apex level for policy making. It is chaired by Minister in-charge, Ministry of Corporate Affairs, Government of India. The members of the Governing Council are:

- Secretary, Ministry of Corporate Affairs, Government of India - Vice Chairman of the Governing Council;
- Second Vice Chairman of the Governing Council (Industry)
- President, Confederation of Indian Industry (CII);
- President, Institute of Chartered Accountants of India (ICAI);
- President, Institute of Company Secretaries of India (ICSI);
- President, The Institute of Cost Accountants of India (ICAI-CMA);
- Director General, Confederation of Indian Industry (CII);
- Secretary, Institute of Chartered Accountants of India (ICAI);
- Secretary, Institute of Company Secretaries of India (ICSI);
- Secretary, The Institute of Cost Accountants of India (ICAI-CMA);
- Chairman, Indian Banks Association;
- Chairman, Insurance Regulatory and Development Authority;
- Chairman, Securities and Exchange Board of India;
- Secretary, Banking Division, Ministry of Finance
- Secretary, Department of Public Enterprises.
- MD and CEO, National Stock Exchange (NSE)
- Director General & CEO, Indian Institute of Corporate Affairs (IICA)
- Eminent Industrialists (4)

(ii) Board of Trustees

Board of Trustees deal with the implementation of policies and programmes and lay down the procedure for the smooth functioning. It is chaired by Secretary, Ministry of Corporate Affairs, Government of India. The members of the Board of Trustees are:

- Director General, Confederation of Indian Industry (CII);
- Secretary, Institute of Chartered Accountants of India (ICAI);
- Secretary, Institute of Company Secretaries of India (ICSI); and
- Secretary, The Institute of Cost Accountants of India (ICAI-CMA)
- Representative, National Stock Exchange (NSE)
- Director General & CEO, Indian Institute of Corporate Affairs (IICA)

(iii) Executive Directorate

The Executive Directorate provides the internal support to NFCG activities and implements the decisions of the Board of Trustees. The Executive Director is the Chief Executive Officer of NFCG. The Executive Directorate exercises such powers as may be delegated to it by the Board of Trustees to carry out such functions as may be entrusted to it by the Board. The Executive Director also functions as the Secretary of the Council and the Board is supported by full time dedicated professional secretariat.

C. ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD)

The Organisation for Economic Co-operation and Development (OECD) was established in 1961 when 18 European countries plus the United States and Canada joined forces to create an organisation dedicated to economic development. It is one of the first non-government organizations to spell out the principles that should govern corporates. The mission of the Organisation for Economic Co-operation and Development (OECD) is to promote policies that will improve the economic and social well-being of people around the world.

Mission of OECD:

The mission of the Organisation for Economic Co-operation and Development (OECD) is to promote policies that will improve the economic and social well-being of people around the world.

The OECD provides a forum in which governments can work together to share experiences and seek solutions to common problems. We work with governments to understand what drives economic, social and environmental change. We measure productivity and global flows of trade and investment. We analyse and
compare data to predict future trends. We set international standards on a wide range of things, from agriculture and tax to the safety of chemicals.

We also look at issues that directly affect everyone’s daily life, like how much people pay in taxes and social security, and how much leisure time they can take. We compare how different countries’ school systems are readying their young people for modern life, and how different countries’ pension systems will look after their citizens in old age.

Drawing on facts and real-life experience, we recommend policies designed to improve the quality of people’s lives. We work with business, through the Business and Industry Advisory Committee to the OECD (BIAC), and with labour, through the Trade Union Advisory Committee (TUAC). We have active contacts as well with other civil society organisations. The common thread of our work is a shared commitment to market economies backed by democratic institutions and focused on the wellbeing of all citizens. Along the way, we also set out to make life harder for the terrorists, tax dodgers, crooked businessmen and others whose actions undermine a fair and open society.

The OECD had focused on helping governments around the world to:

- Restore confidence in markets and the institutions that make them function.
- Re-establish healthy public finances as a basis for future sustainable economic growth.
- Foster and support new sources of growth through innovation, environmentally friendly ‘green growth’ strategies and the development of emerging economies.
- Ensure that people of all ages can develop the skills to work productively and satisfyingly in the jobs of tomorrow.

The OECD provides a forum in which governments can work together to share experiences and seek solutions to common problems. OECD works with governments to understand what drives economic, social and environmental change. OECD measures productivity and global flows of trade and investment analyse and compare data to predict future trends, set international standards on a wide range of things, from agriculture and tax to the safety of chemicals etc.

There are 35 member countries of OECD across the globe. They include many of the world’s most advanced countries but also emerging countries. Currently following Countries are members of OECD - Australia, Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israël, Italy, Japan, Korea, Latvia, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States.

**Council:** Decision-making power is vested in the OECD Council. It is made up of one representative per member country, plus a representative of the European Commission. The work mandated by the Council is carried out by the OECD Secretariat.

**Committees:** Representatives of the 35 OECD member countries meet in specialised committees to advance ideas and review progress in specific policy areas, such as economics, trade, science, employment, education or financial markets. There are about 250 committees, working groups and expert groups.

**Secretariat:** The Secretariat in Paris is made up of about 2500 staff that supports the activities of committees, and carry out the work in response to priorities decided by the OECD Council. The staff includes
economists, lawyers, scientists and other professionals. Most staff members are based in Paris but some work at OECD centres in other countries.

**OECD’s way of working**

OECD’s work is based on continued monitoring of events in member countries as well as outside OECD area, and includes regular projections of short and medium-term economic developments. The OECD Secretariat collects and analyses data, after which committees discuss policy regarding this information, the Council makes decisions, and then governments implement recommendations.

Peer reviews: Mutual examination by governments, multilateral surveillance and a peer review process through which the performance of individual countries is monitored by their peers, all carried out at committee-level, are at the heart of our effectiveness. An example of the peer review process at work is to be found in the Working Group on Bribery, which monitors the implementation by signatory countries of the OECD Convention on Combating Bribery of Foreign Officials in International Business Transactions.

Agreements, standards and recommendations: Discussions at OECD committee-level sometimes evolve into negotiations where OECD countries agree on rules of the game for international co-operation. They can culminate in formal agreements by countries, for example on combating bribery, on arrangements for export credits, or on the treatment of capital movements. They may produce standards and models, for example in the application of bilateral treaties on taxation, or recommendations, for example on cross-border co-operation in enforcing laws against spam. They may also result in guidelines, for example on corporate governance or environmental practices.

**G20/OECD Principles of Corporate Governance**

The OECD Principles of Corporate Governance were first published in 1999. Since then the Principles have become an international benchmark for policy makers, investors, corporations and other stakeholders worldwide. The original principles of OECD were revised and the revised principles were issued in 2004. The revision of the original principles was done to take into account the developments and the corporate governance scandals highlighted the need for improved standards. It was recognized that the integrity of the stock market was critical and to the revised principles were designed to underpin this integrity.

The 2004 version of the Principles were again revised in 2015. A draft of the Principles was discussed by the G20/OECD Corporate Governance Forum in April 2015. Following that meeting, the OECD Council adopted the Principles on 8 July 2015. The Principles were then submitted to the G20 Leaders Summit on 15-16 November 2015, where they were endorsed.

Following are The Principles of Good Corporate Governance as stated in G20/OECD Principles are explained in detail in Chapter No. 6 on Corporate Governance and shareholders right.

**D. INSTITUTE OF DIRECTORS (IOD), UK**

The IOD is a non party-political business organisation established in United Kingdom in 1903. The IOD is charged with promoting good corporate governance for UK business. As such, we strive to ensure our own governance complies with the highest standards. Here’s how our structure works.

**The Board of IOD, UK:** The board of IOD is responsible for the overall leadership of the Institute of Directors (IOD) and setting its values, standards, aims and objectives and delivering them in line with the objects of the Royal Charter. The board is composed of the chair, a majority of non-executive directors, and the director general and executive directors. It acts as a unitary board and has the following powers and responsibilities:

- to manage the affairs and long-term success of the institute
• to approve the strategy of the institute, business and financial planning, to hold the executive to account and ensure financial and risk stewardship

• to approve the annual report and accounts

• to appoint, reappoint and remove (acting by the non-executive directors only) the director general and other executive directors, as the board permits

• to ensure open and transparent engagement with all stakeholders when carrying out its duties

• to establish and dissolve committees and groups of the board

The Council of IOD: The council is the guardian of the IOD constitution, ensuring that the objects of the IOD’s Royal Charter are delivered. It comprises 11 members of geographical areas, 13 elected members and the IOD chairman. The council carries out the following responsibilities:

• to appoint, reappoint and remove the non-executive directors and to determine their independence, having considered any recommendations of the nomination committee

• to hold the board to account for the delivery of the charter objects and adherence to the laws of the institute

• to provide critique and opinion to the board on the overall progress of the institute

• to monitor the board’s engagement with membership and stakeholders

• to appoint and remove a senior independent council member who will act as deputy chair of the council

The IOD seeks to provide an environment conducive to business success.

<table>
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<tr>
<th>Objects of IOD</th>
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<td>(a) to promote for the public benefit high levels of skill, knowledge, professional competence and integrity on the part of directors, and equivalent office holders however described, of companies and other organisations;</td>
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<tr>
<td>(b) to promote the study, research and development of the law and practice of corporate governance, and to publish, disseminate or otherwise make available the useful results of such study or research;</td>
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<tr>
<td>(c) to represent the interests of members and of the business community to government and in all public forums, and to encourage and foster a climate favourable to entrepreneurial activity and wealth creation; and</td>
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<tr>
<td>(d) to advance the interests of members of the Institute, and to provide facilities, services and benefits for them.</td>
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E. COMMONWEALTH ASSOCIATION OF CORPORATE GOVERNANCE (CACG)

The Commonwealth Association of Corporate Governance (CACG) was established in 1998 with the objective of promoting the best international standards germane to a country on corporate governance through education, consultation and information throughout the Commonwealth as a means to achieve global standards of business efficiency, commercial probity and effective economic and social development.

The CACG had two primary objectives:

— to promote good standards in corporate governance and business practice throughout the
Commonwealth; and
— to facilitate the development of appropriate institutions which will be able to advance, teach and disseminate such standards.

The CACG aimed to facilitate the development of institutional capacity that promotes good corporate governance by education, consultation and information in all Commonwealth countries. Corporate governance in the Commonwealth is important and is concerned with:
— the profitability and efficiency of Commonwealth business enterprises, and their capacity to create wealth and employment;
— the long-term competitiveness of Commonwealth countries in the global market;
— the stability and credibility of the Commonwealth financial sectors, both nationally and internationally;
— the relationships between business enterprises within an economy and their sustained ability to participate in the global economy; and
— the relationship between such business enterprises and their various stakeholders comprising shareholders, managers, employees, customers, suppliers, labour unions, communities, providers of finance, etc. The Commonwealth Foundation is funded principally through annual contributions made by member governments.

Board of Governors comprising, in the main, UK-based representatives of member governments and five representatives of civil society, determine the policies

There are 53 countries of the Commonwealth, of which 46 are currently Commonwealth Foundation members. Membership of the Foundation is voluntary, and is open to all Commonwealth governments.

CACG Guidelines

The CACG guidelines set out 15 Principles of corporate governance aimed primarily at boards of directors of corporations with a unitary board structure, as will most often be found in the Commonwealth. The Principles apply equally to boards of directors of all business enterprises – public, private, family owned or state-owned. The Principles are applicable to both executive and non-executive directors. The term “director” should be taken as being synonymous with any person responsible for the direction of a business enterprise. Similarly, the principles can be usefully applied to other forms of enterprise such as non-governmental organisations and agencies.

**Principle 1:** The board should exercise leadership, enterprise, integrity and judgment in directing the corporation so as to achieve continuing prosperity for the corporation and to act in the best interest of the business enterprise in a manner based on transparency, accountability and responsibility.

**Principle 2:** The board should ensure that through a managed and effective process board appointments are made that provide a mix of proficient directors, each of whom is able to add value and to bring independent judgment to bear on the decision-making process.

**Principle 3:** The board should determine the corporation’s purpose and values, determine the strategy to achieve its purpose and to implement its values in order to ensure that it survives and thrives, and ensure that procedures and practices are in place that protect the corporation’s assets and reputation.

**Principle 4:** The board should monitor and evaluate the implementation of strategies, policies, management performance criteria and business plans.
Principle 5: The board should ensure that the corporation complies with all relevant laws, regulations and codes of best business practice

Principle 6: The board should ensure that the corporation communicates with shareholders and other stakeholders effectively

Principle 7: The board should serve the legitimate interests of the shareholders of the corporation and account to them fully

Principle 8: The board should identify the corporation’s internal and external stakeholders and agree a policy, or policies, determining how the corporation should relate to them

Principle 9: The board should ensure that no one person or a block of persons has unfettered power and that there is an appropriate balance of power and authority on the board which is, inter alia, usually reflected by separating the roles of the chief executive officer and Chairman, and by having a balance between executive and non-executive directors

Principle 10: The board should regularly review processes and procedures to ensure the effectiveness of its internal systems of control, so that its decision-making capability and the accuracy of its reporting and financial results are maintained at a high level at all times

Principle 11: The board should regularly assess its performance and effectiveness as a whole, and that of the individual directors, including the chief executive officer

Principle 12: The board should appoint the chief executive officer and at least participate in the appointment of senior management, ensure the motivation and protection of intellectual capital intrinsic to the corporation, ensure that there is adequate training in the corporation for management and employees, and a succession plan for senior management

Principle 13: The board should ensure that all technology and systems used in the corporation are adequate to properly run the business and for it to remain a meaningful competitor

Principle 14: The board should identify key risk areas and key performance indicators of the business enterprise and monitor these factors

Principle 15: The board should ensure annually that the corporation will continue as a going concern for its next fiscal year.

F. INTERNATIONAL CORPORATE GOVERNANCE NETWORK (ICGN)

The International Corporate Governance Network ("ICGN") is a not-for-profit company limited by guarantee and not having share capital under the laws of England and Wales founded in 1995.

ICGN's mission is to promote effective standards of corporate governance and investor stewardship to advance efficient markets and sustainable economies world-wide.

ICGN's positions are guided by the ICGN Global Governance Principles and Global Stewardship Principles, which were first published in 2003, as a statement on shareholder stewardship responsibilities both of which are implemented by:

- Influence policy by providing a reliable source of investor opinion on governance and stewardship;
- Connect peers at global events to enhance dialogue between companies and investors around long
term value creation; and

- Inform dialogue through education to enhance the professionalism of governance and stewardship practices.

It has four primary purposes:

(i) to provide an investor-led network for the exchange of views and information about corporate governance issues internationally;

(ii) to examine corporate governance principles and practices; and

(iii) to develop and encourage adherence to corporate governance standards and guidelines;

(iv) to generally promote good corporate governance.

The Network’s mission is to develop and encourage adherence to corporate governance standards and guidelines, and to promote good corporate governance worldwide.

Membership of ICGN is open to those who are committed to the development of good corporate governance. The Membership section explains the benefits of membership, the different types of membership and how to join the ICGN.

The ICGN is governed by the ICGN Memorandum and Articles of Association.

The management and control of ICGN affairs are the responsibility of the Board of Governors. The Board in turn appoints a number of committees to recommend policy positions, to implement approved projects and to perform such functions that the Board may specify.

The Institute of Company Secretaries of India is a member of ICGN and also the country correspondent from India.

The ICGN Global Governance principles describe the responsibilities of board of directors and investors respectively and aim to enhance dialogue between the two parties. They embody ICGN’s mission to inspire effective standards of governance and to advance efficient markets worldwide. The combination of responsibilities of boards of directors and investors in a single set of Principles emphasizes a mutual interest in protecting and generating sustainable corporate value. These principles were first initiated in 1995. The fourth edition of Principles was released in 2014.

G. EUROPEAN CORPORATE GOVERNANCE INSTITUTE (ECGI)

The European Corporate Governance Institute (ECGI) was founded in 2002. It has been established to improve corporate governance through fostering independent scientific research and related activities.

The ECGI is an international scientific non-profit association. It provides a forum for debate and dialogue between academics, legislators and practitioners, focusing on major corporate governance issues and thereby promoting best practice.

Vision Statement of ECGI:

- Corporate governance lies at the heart of our capitalist systems. It is the interface between capital markets and companies, between employees and executives, and between society and the corporate sector. It is the driver of what companies do, how they do it and the effects they have on others. In other words, it sits at the centre of the success and failure of our economic systems.
• As such it warrants knowledge, research and insights of the best thinkers, practitioners and policymakers of our age. That is precisely what ECGI seeks to provide. It draws on the finest minds in academia from all over the world to tackle some of the most important issues that confront business and governments today. It uses the power of research to change ideas, influence practice and formulate policy to benefit all of us.

• Corporate governance refers to the way in which private and public companies, enterprises, entrepreneurship and financial institutions are governed and run in relation to their purpose, values, ownership, representation, accountability, financing, investment, performance, leadership, direction, management, employment, law, regulation and taxation.

Mission Statement of ECGI:

• The mission of ECGI is to assist the top academics in the field of corporate governance in bringing their research to the attention of leading practitioners, policymakers and thought leaders by making state of the art knowledge accessible and relevant to them. It promotes the development of new ideas through research that extends the boundaries of our understanding of how corporate governance contributes to the flourishing of business, economies and societies.

Its primary role is to undertake, commission and disseminate research on corporate governance. Based upon impartial and objective research and the collective knowledge and wisdom of its members, it advises on the formulation of corporate governance policy and development of best practice and undertake any other activity that will improve understanding and exercise of corporate governance.

It acts as a focal point for academics working on corporate governance in Europe and elsewhere, encouraging the interaction between the different disciplines, such as economics, law, finance and management.

The Institute articulates its work by expanding on the activities of the European Corporate Governance Network, disseminating research results and other relevant material.

It draws on the expertise of scholars from numerous countries and brings together a critical mass of expertise and interest to bear on this important subject.

H. CONFERENCE BOARD

The Conference Board was established in 1916 in the United States of America. The Conference Board is a global, independent business membership and research association working in the public interest and is a not-for-profit organization. The Conference Board creates and disseminates knowledge about management and the marketplace to help businesses strengthen their performance and better serve society.

Mission: The Conference Board is dedicated to equipping the world's leading corporations with the practical knowledge they need to improve their performance and better serve society. We are an objective, independent source of economic and business knowledge with only one agenda: to help our members understand and deal with the most critical issues of our time.

It works as a global, independent membership organization in the public interest, it conducts research, convenes conferences, makes forecasts, assesses trends, publishes information and analysis, and brings executives together to learn from one another.

The Conference Board governance programs helps companies improve their processes, inspire public confidence, and ensure they are complying with regulations.
The Conference Board Directors' Institute is a premiere provider of governance education for directors. Through the Directors' Institute, the program provides corporate directors with a non academic, impartial forum for open dialogue about the real-world business challenges they face.

The Corporate Governance program at The Conference Board has helped corporations develop strong core principals by improving their governance processes through a variety of programs including director training and global ethics education.

The Conference Board Global Corporate Governance Research Center brings together a distinguished group of senior corporate executives from leading world-class companies and influential institutional investors in a non-adversarial setting. In small groups of prominent senior executives, all discussions are confidential, enabling a free-flowing exchange of ideas and effective networking. This highly unique forum allows industry leaders to debate, develop, and advance innovative governance practices, and to drive landmark research in corporate governance.

I. ASIAN CORPORATE GOVERNANCE ASSOCIATION (ACGA)

The Asian Corporate Governance Association (ACGA) is an independent, non-profit membership organisation dedicated to working with investors, companies and regulators in the implementation of effective corporate governance practices throughout Asia. ACGA was founded in 1999 from a belief that corporate governance is fundamental to the long-term development of Asian economies and capital markets.

ACGA's scope of work covers three areas:

1. Research:
   Tracking corporate governance developments across 11 markets in Asia and producing independent analysis of new laws and regulations, investor activism and corporate practices.

2. Advocacy:
   Engaging in a constructive dialogue with financial regulators, stock exchanges, institutional investors and companies on practical issues affecting the regulatory environment and the implementation of better corporate governance practices in Asia.

3. Education:
   Organising conferences and seminars that foster a deeper understanding of the competitive benefits of sound corporate governance and ways to implement it effectively.

ACGA is funded by a network of sponsors and corporate members, including leading pension and investment funds, other financial institutions, listed companies, multinational corporations, professional firms and educational institutions. It is incorporated under the laws of Hong Kong and is managed by a secretariat based there. Its governing Council comprises directors from around Asia.

J. CORPORATE SECRETARIES INTERNATIONAL ASSOCIATION (CSIA)

The CSIA an international federation of professional bodies that promotes the best practices in corporate secretarial, corporate governance and compliance services. It is international federation of governance professional bodies for corporate secretaries & governance professional and represents those who work as frontline practitioners of governance throughout the world.

Vision Statement: To be the Global Voice of Corporate Secretaries and Governance Professionals.

Mission Statement: To create a global profession that develops, grows and promotes best practice in
corporate secretarial, corporate governance and compliance services by improving professional standards, the quality of governance practice and organizational performance.

Strategic Goals:

- **Reputation** - To establish CSIA as the authority on corporate secretarial, corporate governance and create a global professional organisation.

- **Growth** - To grow a community of corporate secretaries and governance professionals to expand our influence

- **Advocacy** - To promote best practice in corporate secretarial, corporate governance and compliance services

Objectives:

- To promote throughout the world the professional status of suitably qualified chartered secretaries, corporate secretaries, company secretaries, certified secretaries, board secretaries, governance professionals and other professionals with similar specialist governance qualities or skills to the public, government, regulators, the business community and international organisations.

- To raise awareness and visibility of secretaryship and its Practitioners and to actively promote these in terms of recognition, influence and respect to national governments and their supplementary/sponsored organisations, international organisations and the global business community.

- To establish and maintain throughout the world good relations and exchanges between organisations dedicated to the promotion and practice of secretaryship and/or the promotion of good governance which will enable and encourage the establishment of common aims and objectives to be pursued by chartered secretaries, corporate secretaries, company secretaries, board secretaries, governance professionals or similar other professionals who are Practitioners as defined in Article 3(1).

- To assist such organisations throughout the world to develop and improve their services and professionalism of their members.

- To assist in the creation of such organisations in countries or regions in which they do not currently exist.

- To promote the growth, development, study and practice of secretaryship

- To promote and recommend uniformity in governance standards.

- To promote and actively support good governance

- To promote and carry out research into good governance and secretaryship practices

**Twenty Practical Steps to Better Corporate Governance**

1. Recognize that good corporate governance is about the effectiveness of the governing body — not about compliance with codes

2. Confirm the leadership role of the board chairman

3. Check that non-executive directors have the necessary skills, experience, and courage

4. Consider the calibre of the non-executive directors
5. Review the role and contribution of non-executive directors
6. Ensure that all directors have a sound understanding of the company
7. Confirm that the board’s relationship with executive management is sound
8. Check that directors can access all the information they need
9. Consider whether the board is responsible for formulating strategy
10. Recognize that the governance of risk is a board responsibility
11. Monitor board performance and pursue opportunities for improvement
12. Review relations with shareholders — particularly institutional investors
13. Emphasise that the company does not belong to the directors
14. Ensure that directors’ remuneration packages are justifiable and justified
15. Review relations between external auditors and the company
16. Consider relations with the corporate regulators
17. Develop written board-level policies covering relations between the company and the societies it affects
18. Review the company’s attitudes to ethical behaviour
19. Ensure that company secretary’s function is providing value
20. Consider how corporate secretary’s function might be developed.

PARAMETERS OF BETTER GOVERNED COMPANIES

Better-governed companies are rewarded with higher market valuations, are less leveraged, have greater capacity to service their debts and pay dividends and enjoy more stable profit margins compared to their peers. There is evidence of a positive and significant relationship between corporate governance practices and company performance.

The parameters covering various facets of corporate governance, including shareholder capital, shareholder rights, financial and operational information, board and management information and remuneration, corruption, leadership and business ethics.

The ICSI National Awards for Excellence in Corporate Governance

In pursuit of excellence and to identify, foster and reward the culture of evolving globally acceptable standards of corporate governance among Indian companies, the “ICSI National Award for Excellence in Corporate Governance” was instituted by ICSI in the year 2001. The Awards comprising citation and trophy are based on the outcome of concerted and comprehensive process of evaluation which enables the Jury to judge on the basis of parameters, the practices of corporate governance as followed by Indian corporates and acknowledge the best practices worthy of being exemplified. The underlying guideline for the Corporate Governance Award is to identify the corporates, which follow the best corporate governance norms in letter and spirit.

The institution of the Award aims at promoting the cause of Corporate Governance by:

- Recognizing leadership efforts of corporate boards in practising good corporate governance principles in their functioning;
Recognizing implementation of innovative practices, programmes and projects that promote the cause of corporate governance;

- Enthusing the corporates in focusing on corporate governance practices in corporate functioning; and

- Implementation of acknowledged corporate governance norms in letter and spirit.

The Institute annually bestows upon a corporate leader the “ICSI Lifetime Achievement Award for Translating Excellence in Corporate Governance into Reality” keeping in view the attributes like:

- Outstanding contribution to social upliftment and institution building;
- Exemplary contribution in enhancement of stakeholders’ value;
- A visionary with innovative ideas;
- Long tradition of trusteeship, transparency and accountability;
- Qualities of leadership, team spirit, integrity and accountability;
- Proven track record of adherence of statutory obligations; and
- Social acceptance and approval.

GLOSSARY OF TECHNICAL WORDS

- **Capacity Building**: Process by which organisations obtain, improve and retain the skills, knowledge and other resources needed to do their jobs competently.

- **Trustee**: An individual person or member of the Board given control or powers of administration of properties interest with a legal obligation to administer it solely for the specified purpose.

- **Peer Reviews**: Peer review process is a process through which the performance of individual countries is monitored by their peers, all carried out at committee-level, are at the heart of our effectiveness.

LESSON ROUND UP

- The ICSI Vision and Mission; The ICSI Philosophy on Corporate Governance; The ICSI’s approach to Corporate Governance provides the solution to the development issues.

- The National Foundation for Corporate Governance - NFCG endeavours to build capabilities in the area of research in corporate governance and to disseminate quality and timely information to concerned stakeholders; The NFCG Mission; The internal governance structure of NFCG.

- OECD - The OECD Principles of Corporate Governance set out a framework for good practice which was agreed by the governments of all 30 countries that are members of the OECD. The OECD Principles covers six areas.

- The IoD is a non party-political business organisation established in United Kingdom in 1903. The IoD seeks to provide an environment conducive to business success.

- The Commonwealth Association of Corporate Governance (CACG) was established in 1998 with the objective of promoting the best international standards on corporate governance throughout the Commonwealth as a means to achieve global standards of business efficiency, commercial probity and effective economic and social development.

- The International Corporate Governance Network (“ICGN”) is a not-for-profit company limited by guarantee under the laws of England and Wales. The Network’s mission is to develop and encourage adherence to
corporate governance standards and guidelines, and to promote good corporate governance worldwide.

- The European Corporate Governance Institute (ECGI) was founded in 2002. It has been established to improve corporate governance through fostering independent scientific research and related activities.

- The Conference Board was established in 1916 in the United States of America. The Conference Board governance programs help companies improve their processes, inspire public confidence, and ensure they are complying with regulations.

- The Asian Corporate Governance Association (ACGA) is an independent, non-profit membership organisation dedicated to working with investors, companies and regulators in the implementation of effective corporate governance practices throughout Asia.

- CSIA is dedicated to promoting the values and practices of governance professionals in order to create, foster or enhance the environment in which business can be conducted in a fair, profitable and sustainable manner.

## SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Briefly discuss the initiatives of the Institute of Company Secretaries of India in the area of Corporate Governance.

2. Briefly discuss about the scope of work undertaken by the National Foundation for Corporate governance.

3. Discuss about the Organisation for Economic Co-operation and Development

4. Write notes on:
   - (a) Commonwealth Association for Corporate Governance
   - (b) Institute of Directors
   - (c) International Corporate Governance Network
   - (d) European Corporate Governance Institute
   - (e) Conference Board
   - (f) Asian Corporate Governance Association
   - (g) Corporate Secretaries International Association

## REFERENCE FOR FURTHER READING

**Publications:** OECD publications are a prime vehicle for disseminating the Organisation's intellectual output. OECD publishes regular outlooks, annual overviews and comparative statistics. Among them:

- OECD Economic Outlook assesses prospects for member and major non-member economies.

- OECD Factbook is a key reference tool for everyone working on economic and policy issues.

- OECD Economic surveys provide individual national analyses and policy recommendations.

- Going for Growth 2017 presents comparative indicators and evaluations of national performance.

Following are the links of international forums, students may refer at the websites of these institutions for
latest updates and information.

- http://www.nfcgindia.org
- www.oecd.org/daf/corporateaffairs/principles/text
- http://www.iod.com
- http://www.icgn.org/
- www.ecgi.org/
- http://www.conference-board.org/
- http://www.acga-asia.org/
- www.csiaorg.com
Lesson 10
Promoters and Minority Shareholders

LESSON OUTLINE

- Promoter
  - Role of Promoter
  - Promoter – Indian Context
  - Liabilities of Indian Promoter
- Majority and Minority Shareholders
- Governance of Corporate Groups
- Monitoring of Subsidiary Companies in India
- Financial Oversight
- National Financial Reporting Authority (NFRA)
- Audit Committee
- Strengthening Financial Reporting Standards
- Conclusion
- Glossary
- Lesson Round-Up
- Self Test Questions

LEARNING OBJECTIVES

The objective of this study lesson is to enable the students to understand:

- The role of promoters, their liabilities and remedies in case of breach of duty
- The concept of majority and minority shareholders
- Rights of minority shareholders and the measures they can take to prevent oppression and mismanagement
- Understanding the structure and elements of a corporate group
- Appreciating the governance concerns of group entities
- Regulations with respect to governance of Corporate Groups in India
- The need for financial oversight
- Measures taken to enhance auditors effectiveness
- Role of Auditors in financial oversight of the company

This chapter may be useful in performing advisory roles with regard to the promoters, minority shareholders, governance of group companies and financial oversight.
INTRODUCTION

This Chapter describes the promoters, their role in incorporation of a company, concept of majority and minority shareholders and rights thereof, describing the concept of structure and elements of a corporate group, regulations with respect to Governance of Corporate Groups, the need of financial oversight, role of auditor and audit committee & its effectiveness and functions of National Financial Reporting Authority.

PROMOTER

A promoter is a person, firm or company who does the preliminary work for the formation of a company, including framing its memorandum and articles of association, its incorporation process and initial raising of capital for business. Securities Exchange Commission Rule of US 405 (a) defines promoter as a “person who acting alone or in conjunction with other persons directly or indirectly takes the initiative in founding or organizing the business enterprise.”

A promoter is neither a trustee nor an agent of the company but he has a fiduciary relationship with the company. Fiduciary relation means a relation of trust and confidence.

“The promoters of a company stand undoubtedly in a fiduciary position. They have in their hands the creation and moulding of the company. They have the power of defining how and when and in what shape and under what supervision, it shall start into existence and begin to act as a trading corporation.”

Lord Cairns, Erlanger V. New Sembrero Phosphate Co

This implies they should act in good faith and not take any undue advantage from the company or make any unfair gains from it.

Promoter is a person who as principal procures or aids in procuring the incorporation of a company. [Phosphate Sewage Co. v. Hartmount [1876] 5 Ch. D. 394/Official Receiver & Liquidator of Jubilee Cotton Mills Ltd. v. Lewis [1924] AC 958 (HL)]

Role of Promoters

Role in Incorporation: The promoter is required to do the needful to form the company so that it can start functioning. This includes:

- To conceive an idea of forming a company
- To decide and have the name of the company approved
- To find minimum subscribers
- Identify the first directors of the company
- Complete the process of registering the company such as drafting and filing of memorandum and articles of association, deciding its registered office and determining its share capital

Promoters may also help in issuing prospectus and raising capital.

Entrepreneur promoters continue to be involved in the day to day business of the company as directors whereas professional promoters limit their role to setting up the company for a professional fee.

Fiduciary Role: The promoter holds a fiduciary position towards the company. Hence he must not misuse his power. He has a duty:
• Not to make any secret profit out of the promotion of the company;
• To disclose to the company any interests which he has in a transaction entered into by it.

A promoter is allowed to make profit, only it should not be kept secret and be duly disclosed in the annual general meeting and prospectus. All transactions must be fully disclosed in the Annual General meeting. In the case of *Gluckstein v. Barnes*, (1900 AC 240) promoters bought a property and sold it for profits to the company in which they were first directors. They did not disclose this. It was held by the court that the promoters were bound to pay the secret profit earned to the company.

**Execute Pre-incorporation Contracts:** Sometimes, contracts are made even before company is even incorporated, these are called pre-incorporation contracts. The promoters may enter into such contacts on behalf of the company. If the contract is warranted by the terms of incorporation the company may enforce it. ‘Warranted by terms of incorporation’ means within the scope of company’s objects as stated in Memorandum of Association. The other party also has the right to enforce the pre-incorporation contracts against the Company. (Special Relief Act, 1963)

The promoter is to act honestly, diligently and in the best interest of the company.

**Remedies in case of Breach of Duties**

When a promoter commits a breach of duties that he owed to the company, the company may either;
• Rescind the contract, or
• Recover secret Profits

**Rescission of contract:** A company can rescind within reasonable time all such pre-incorporation agreements where promoter has made a secret profit and has not disclosed his material interests in the transactions. The company must have done nothing to show an intention to ratify the agreement after finding breach

**Recovery of secret profits:** As noted in the case of *Gluckstein v. Barnes* a company can recover secret profits made by promoters.

**Promoter – Indian Context**

Companies Act, 2013: According to Sec 2 (69) of Companies Act, 2013 a promoter” means a person—
(a) who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or
(b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or
(c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act:

Provided that nothing in sub-clause (c) shall apply to a person who is acting merely in a professional capacity.

From the above definition, ‘promoter’ is not only a person who have been named in the prospectus, but all those persons who have control over the affairs of the company or on whose advise the board of Directors are accustomed to act. However, by way of proviso to the definition, it has been made clear that the persons who are rendering services to the company in their professional capacity shall not be considered promoters e.g. Company Secretary, Chartered Accountant, Cost Accountant, Lawyers, Merchant Banker, Lead Manager etc.
Further in sub-clause (b) above, the word ‘control’ has been used. The “control” has been defined by section 2(27) in the Companies Act, 2013 which reads as under:

"control" shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

In India, a large number of companies are family owned where the promoters are the majority or controlling shareholder group. They either directly manage the day-to-day affairs of the company or indirectly influence its activities. With their significant holding they can make all the decisions in the company including appointment of directors. This power they have has been recognised by the Companies Act, 2013 in the definition of promoter and hence they can be held liable for their actions as promoters.

SEBI (ICDR) 2009

The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, has defined the word(s) ‘promoter’ and ‘promoter groups’ as under;

In terms of Regulation 2(1)(za), “promoter” includes:

a. the person or persons who are in control of the issuer;

b. the person or persons who are instrumental in the formulation of a plan or programme pursuant to which specified securities are offered to public;

c. the person or persons named in the offer document as promoters:

Provided that a director or officer of the issuer or a person, if acting as such merely in his professional capacity, shall not be deemed as a promoter:

Provided further that a financial institution, scheduled bank, foreign portfolio investor other than Category III foreign portfolio investor and mutual fund shall not be deemed to be a promoter merely by virtue of the fact that ten per cent or more of the equity share capital of the issuer is held by such person:

Provided further that such financial institution, scheduled bank and foreign portfolio investor other than Category III foreign portfolio investor shall be treated as promoter for the subsidiaries or companies promoted by them or for the mutual fund sponsored by them.

Further in terms of Regulation 2(1)(zb), "promoter group" includes:

(i) the promoter;

(ii) an immediate relative of the promoter (i.e., any spouse of that person, or any parent, brother, sister or child of the person or of the spouse); and

(iii) in case promoter is a body corporate:

(A) a subsidiary or holding company of such body corporate;

(B) any body corporate in which the promoter holds ten per cent or more of the equity share capital or which holds ten per cent or more of the equity share capital of the promoter;

(C) any body corporate in which a group of individuals or companies or combinations thereof which hold twenty per cent or more of the equity share capital in that body corporate also holds twenty per cent or more of the equity share capital of the issuer; and
(iv) in case the promoter is an individual:
   
   (A) any body corporate in which ten per cent or more of the equity share capital is held by the 
   promoter or an immediate relative of the promoter or a firm or Hindu Undivided Family in which 
   the promoter or any one or more of his immediate relative is a member; 
   
   (B) any body corporate in which a body corporate as provided in (A) above holds ten per cent or 
   more, of the equity share capital; 
   
   (C) any Hindu Undivided Family or firm in which the aggregate shareholding of the promoter and his 
   immediate relatives is equal to or more than ten per cent of the total; and 
   
(v) all persons whose shareholding is aggregated for the purpose of disclosing in the prospectus under 
the heading "shareholding of the promoter group": 

  Provided that a financial institution, scheduled bank, foreign port-folio investor other than Category 
III foreign portfolio investor and mutual fund shall not be deemed to be promoter group merely by 
virtue of the fact that ten per cent or more of the equity share capital of the issuer is held by such 
person: 

  Provided further that such financial institution, scheduled bank and foreign portfolio investor other 
than Category III foreign portfolio investor shall be treated as promoter group for the subsidiaries or 
companies promoted by them or for the mutual fund sponsored by them; 

### Liabilities of Indian Promoters

The general role of promoters as discussed is applicable anywhere including in India. Companies Act, 2013 
(Act) does not lay down specific duties of the promoter. However various sections impose liabilities on 
promoters under certain conditions even when they are not directors or employees of the company. 

**Officer in Default:** Under Section 2(59) and Section 2(60) any person in accordance with whose advice, 
directions or instructions the Board of Directors of the company is accustomed to act can be treated as an 
officer in default. Thus promoter if found in default of provisions of the act may be penalised with fine or 
punished by imprisonment. 

**Incorrect information during incorporation:** Promoters shall be liable if they furnish any false or incorrect 
information in the documents filed at the time of registration of the company. (Sec 7) 

**False or misleading Prospectus:** Promoters who authorise a prospectus which is untrue or misleading are 
subject to criminal liability (Sec 34) and civil liability and are required to pay compensation to every person 
who has sustained loss or damage because of such prospectus. (Sec 35) 

**Case Law:** Non-investment of monies in manner stated in prospectus does not amounts to violation of 
statement or mis-statement as issuance of statement and abiding by promises are two different activities; 
proceedings against petitioner director for mis-statement was to be quashed. [Dr. T. H. Chowdary v. 
Registrar of Companies]¹, CRL. Petition Nos. 5428,5431 & 5540 OF 2010, March 28, 2013 

**Case Law:** Where appellant was promoter of company and was party to share purchase agreement by 
which shares of company were fraudulently sold to respondent, award passed by Arbitral Tribunal fastening 
liability upon appellant and her husband to pay damages to respondent was justified. [Ritika Awasty v. 
Hassad Netherlands BV², FAO (OS) COMM NO. 59 OF 2016, September 5, 2016] 

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¹ [2014] 47 taxmann.com 213 (Andhra Pradesh) 
² [2016] 73 taxmann.com 204 (Delhi)
Contravention of Provisions of Raising Equity Capital: Similarly if the promoters contravene any provisions of the act while issuing prospectus or during private placement they may be penalised or imprisoned. (Sec 26 and Sec 42)

Section 26(9) which deals with the ‘Matters to be stated in the prospectus’ states that if a prospectus is issued in contravention of 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 three lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with.

Section 42(10) which deals with the ‘Issue of shares on private placement basis’, provides that if a company makes an offer or accepts monies in contravention of this section, the company, its promoters and directors shall be liable for a penalty which may extend to the amount raised through the private placement or two crore rupees, whichever is lower, and the company shall also refund all monies with interest as specified in sub-section (6) to subscribers within a period of thirty days of the order imposing the penalty.

Case Law: In the case of Sahara India Real Estate Corp. Ltd. v. Securities and Exchange Board of India³, Civil Appeal NOS. 9813 & 9833 OF 2011, August 31, 2012, the Supreme Court held that ‘Share and debenture issue’ meant for more than 49 persons would be a public issue - OFCDs issued to more than forty nine persons requires compliance of norms of public issue, in violation of which money collected from public is to be refunded. Company offering shares to public should file application on recognised stock exchange - Every company which intends to offer shares or debentures to public for subscription by way of a prospectus is legally obliged to make an application on a recognised stock exchange. SEBI's powers under section 11 of SEBI Act are applicable to both listed and unlisted companies. Functions and powers of SEBI under section 11, insofar as protecting interest of investors in securities market, as also, for promotion, development and regulation of securities market, would be applicable to 'listed' as well as 'unlisted companies'. Definition of securities u/s 2(45AA) includes hybrids - Definition of 'securities' under section 2(45AA) of Companies Act includes 'hybrids' and SEBI has jurisdiction over hybrids like OFCDs.

Improper Notice of General Meeting: Section 102 deals with the matters relating to “Statement to be annexed to notice”. Its sub-section (5) states that if any default is made in complying with the provisions of this section, every promoter, director, manager or other key managerial personnel who is in default shall be punishable with fine which may extend to fifty thousand rupees or five times the amount of benefit accruing to the promoter, director, manager or other key managerial personnel or any of his relatives, whichever is more.

Case Law: Where applicant had received notice of Extra Ordinary General Meeting, he was at liberty to attend meeting and raise his voice, if any and no order to restrain holding of meeting on ground of violation of section 102 was to be passed. [Yatin Chandulal Davda v. Iberchem India Ltd.⁴, I.A. NO. 290/NCLT/AHM/2017, C.P. Nos. 172/241-242/NCLT/AHM/2017, October 5, 2017]

Co-operate with Official Liquidator

Section 284 deals in the matters relating to “Promoters, directors, etc., to cooperate with Company Liquidator”. Its sub-section (2) provides that where any person, without reasonable cause, fails to discharge his obligations under sub-section (1), he shall be punishable with imprisonment which may extend to six months or with fine which may extend to fifty thousand rupees, or with both.

³ [2012] 25 taxmann.com 18 (SC)
⁴ [2018] 90 taxmann.com 119 (NCLT - Ahd.)
Case Law: In the case of *H.D.F.C. Bank Ltd. v. Suresh Chandera V. Parekh*, CA No. 69/2010 CP No. 10/284/CLB/WR/2005, December 9, 2013, the Opposite parties demanded certain shares of petitioner bank which was declined. Feeling aggrieved, they sent notice under section 284, read with section 190, for inclusion of resolution for removal of M from office and position of Director, at AGM held in 2001, 2002 and 2005. Petitioner bank filed civil petition for ensuring that opposite party could not indulge in future misuse and abuse of process of law by serving notice for removal of M as Director on same issue or by raising any other issue against them. Present Bench passed order restraining opposite parties from sending any further notices to bank. However, these opposite parties again sent a notice to petitioner-bank seeking removal of M as director on same ground as mentioned in earlier notice. Company Law Board, New Delhi Bench, held that opposite party being aware of earlier orders, and wilfully disobeyed them by sending notices to petitioner bank for removal of M as director under section 284. Such an act amounted to civil contempt as envisaged under Contempt of Courts Act, 1971. Since no appeal had been filed by opposite parties against earlier order, it was binding upon them.

**Fraudulent conduct of business:** Section 339 deals with the matters relating to ‘Liability for fraudulent conduct of business’. At the time of winding up if it is found that promoters conducted business of the company with intent to defraud creditors of the company or any other persons or for any fraudulent purpose the tribunal can hold the promoters personally liable, without any limitation for all or any of the debts of the company. Its sub-section (3) provides that where any business of a company is carried on with such intent or for such purpose as is mentioned in sub-section (1), every person who was knowingly a party to the carrying on of the business in the manner aforesaid, shall be liable for action under section 447.

**Vacation of the office of director (Section 167) and Resignation of director (Section 168):** Besides the first directors, if all directors resign or their offices are vacated the promoters may appoint the required directors till the next general meeting. (Sec 167 and Sec 168)

Case Law: Where in a board meeting appellant directors removed R3 from directorship of company without giving any notice with agenda items as prescribed under Companies Act to him and date of board meeting in notice allegedly sent to R3 for calling meeting was different from date shown in Form 32 filed with ROC, vacation of office by director in terms of section 283(1)(g) was invalid. [*Ajith Kunimal Venugopal v. Oil Tools International Services (P.) Ltd.*], Company Appeal (at) 338 of 2017, March 9, 2018

**MAJORITY AND MINORITY SHAREHOLDERS**

When an individual, organization or group of shareholders together hold or control more than 50% shares of the company they are known as majority shareholders. This gives them absolute control over the operations of the company particularly selection of board by deciding who will be appointed as directors.

If a company has a majority shareholder then all other shareholders become minority shareholders as they hold less than 50% shares. Let’s say company Y has two shareholders A with 51% and B with 49%, than A is the majority shareholder and B the minority shareholder. On the other hand company X has shareholder C with 51% and 49 more shareholders with 1% shareholding each. Then C is the majority shareholder and all other are minority shareholders.

Typically in Indian family firms promoters along with their family control majority shares with other shareholders holding small percentage of shares. India has a large number of family-owned listed
companies with promoter group holding 51% or more in most cases. They thus dominate and run the company in a way that best protects their own interest.

**Minority Shareholders Rights**

Minority Shareholders, even as minorities have all the rights of a shareholder. According to OECD principles (OECD, 2015) ‘the corporate governance framework should protect and facilitate the exercise of shareholders’ rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.” As an equity shareholder, minority have the right to:

- participate in the profits of the company
- information about the company
- participation in general shareholder meetings and influence corporate actions through voting on proposals

However, more often than not small shareholders don’t exercise their rights either due to unawareness of their rights or inability to participate in meetings. Small shareholders are dispersed across the country and travelling to the venue is time consuming and costly. Those with short term investment horizons are only looking at an opportunity of making quick profits on their investment and thus have no desire to get involved in the affairs of the company. Sometimes small shareholders do not bother to participate as they are view that the cost of voting is more than the benefit or their vote won’t matter as majority shareholder’s decision prevails.

As a result promoter group can have effective control or ‘controlling interest’ of the company with a small block holding of only 15% to 30% and need not hold on to the entire 50% shares of the company.

The interests, goals, and investment horizons of majority shareholders may vary from minority shareholders. Majority shareholder may decide on investing company surplus in a new risky venture whereas minority shareholders may prefer return in the form of dividends. A proper balance of the rights of majority and minority shareholders enables efficient functioning of the company.

**Special Rights:** As ‘the will of the majority prevails’ the decision of majority shareholders in a company binds the minority. They exercise their rights without considering the interests of minority. They may misuse their power to exploit the rights of minority. Hence Companies Act, 2013 provides some special powers to small shareholders to prevent exploitation of their rights.

**Representation on Board:** Section 151 allows ‘small shareholders’ (which means a shareholder holding shares of nominal value of not more than twenty thousand rupees) of listed companies to appoint a director. 1000 or 1/10th shareholders whichever is less may give notice to the company and elect a director. This provides them a representation on the board who can express their interests. (It may be noted that all minority shareholders may not be small shareholders)

Case Law: In a suit company ‘C’ stated that ‘R’ was wrongly claiming to be a director of the company though he was neither appointed as a director of the company nor co-opted as a director of the company. It was also the case that the defendant did not hold any shares in the company, nor had the defendant obtained any shares till the date. The company sought for perpetual injunction against the defendant restraining him from acting as director and from operating bank accounts or dealing with the funds of the company or using the seal or otherwise interfering with the management of the company. The trial judge dismissed the application while on appeal, the Division Bench accepted the company’s view and the defendant had been restrained from function as a director of the company.
The Supreme Court in this case held that when the whole question was whether the defendant was in law entitled to function as a director the trial Judge, instead of considering returns sent to Registrar of Companies had given more weight to the fact that the defendant had been de facto functioning as a director. The trial Judge was not also justified in brushing aside the share registers and other minute books produced by the plaintiff to establish that the defendant was neither a shareholder nor had he been appointed a director. When once from the records produced by the company it was evident prima facie that the defendant was not shown as a shareholder and that he had not been appointed as a director as claimed by him, and that S did not cease to be a director from 31-8-1964, the Appellate Court was perfectly justified in granting the injunction restraining the defendant from functioning as a director. The Appellate Court was also perfectly justified in drawing an adverse inference against the defendant about his having become a shareholder, having due regard to the fact that he had instituted a suit for rectification of the share register only as late as 21-11-1966, though he claimed to have obtained a transfer of shares as early as on 30-10-1963. [Ram Autar Jalan v. Coal Products (P.) Ltd.\textsuperscript{7}, CIVIL APPEAL NOS. 1412 AND 1413 OF 1968, DECEMBER 20, 1968]

**E-Voting:** Voting by electronic means is a facility given to the members of a company with more than 1000 shareholders to cast their votes on the resolutions through electronic mode. It provides an opportunity to shareholders residing in far-flung area to take part in the decision making process of the company. Shareholders can therefore exercise their voting rights even when they cannot be physically present for meetings and without spending too much time or money.

**Exit Rights:** If a person or group of persons acquire 90% of the shares through amalgamation, share exchange or by any other way then they will offer to buy out the shares of the minority shareholders at a price determined as per regulations. This gives the minority shareholders and opportunity to exit from the company. (Section 236)

The workflow process as prescribed under section 236 shall be as follows:

![Workflow Diagram]

**Related Party Transactions:** If the company is entering into a contract or agreement with majority shareholder group, it will be deemed as related party transaction and if the transaction is not at arm’s length, minority shareholders through a special resolution can approve or disapprove the transaction.  

\textsuperscript{7} [1970] 40 COMP CASE 715 (SC)
Shareholders being interested party will not be able to vote so the minority shareholders will have the final say. (Sec 188)

**Case Law:** Where applicant company transferred certain funds to its related concern without taking approval of concerned authority and thereby contravened provisions of section 297 of 1956 Act, (Section 188 of CA 2013) even though said amount was received back from related concern after 3 years without charging any interest, yet it caused substantial loss to shareholders of company and, therefore, applicant's application seeking compounding of offence was to be allowed subject to payment of huge compounding fee., [Deccan Chronicle Holdings Ltd. (DCHL) v. Registrar of Companies, CA NO. 01/621A/HDB/2016, July 5, 2017]

**Oppression and Mismanagement:** Part XVI consisting of Sections from 241 to 246 of Companies Act, 2013 deals with prevention of Oppression and Mismanagement. When a shareholder’s rights are violated it can be termed as oppression. Oppression occurs when the majority shareholders misuse their rights and take company's business as their personal property resulting in loss to the minority shareholders.

Conditions for Oppression and Mismanagement: Section 241(1) provides that any member of a company who complains that:

(a) the affairs of the company have been or are being conducted in a manner
   - prejudicial to public interest or
   - prejudicial or oppressive to any member or members or
   - prejudicial to the interests of the company;

OR

(b) material change, not being a change brought about by, or in the interests of, any creditors, including debenture holders or any class of shareholders of the company, has taken place in the management or control of the company whether by
   - an alteration in the Board of Directors, or manager, or
   - in the ownership of the company’s shares, or if it has no share capital, in its membership, or
   - in any other manner whatsoever, and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to its interests or its members or any class of members,

may apply to the Tribunal, provided such member has a right to apply under section 244, for an order under this Chapter.

(2) The Central Government, if it is of the opinion that the affairs of the company are being conducted in a manner prejudicial to public interest, it may itself apply to the Tribunal for an order under this Chapter.

**Application for Relief:** Not less than 100 shareholders or one-tenth of the shareholders in case of a company having share capital or one-fifth members when the company has no share capital can apply to the National Company Law Tribunal for relief, if they are of the opinion that they are being oppressed or company is being mismanaged.

National Company Law tribunal (NCLT) is a quasi-judicial body set up by the government of India under Section 408 of Companies Act 2013 to adjudicate issues relating to Indian companies.

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8 [(2017) 83 taxmann.com 315 (NCLT - Hyd.)]
Relief Measures: Section 242 provides that if, on any application made under section 241, the Tribunal is of the opinion—

(a) that the company's affairs have been or are being conducted in a manner prejudicial or oppressive to any member or members or prejudicial to public interest or in a manner prejudicial to the interests of the company; and

(b) that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding up order on the ground that it was just and equitable that the company should be wound up,

the Tribunal may, with a view to bringing to an end the matters complained of, make such order as it thinks fit.

If the Tribunal is of the opinion that oppression or mismanagement has taken place it may either order winding up if that is just and equitable and if it is not appropriate to wind up the company, it may order:

(a) the regulation of conduct of affairs of the company in future;

(b) the purchase of shares or interests of any members of the company by other members thereof or by the company;

(c) in the case of a purchase of its shares by the company as aforesaid, the consequent reduction of its share capital;

(d) restrictions on the transfer or allotment of the shares of the company;

(e) the termination, setting aside or modification, of any agreement, howsoever arrived at, between the company and the managing director, any other director or manager, upon such terms and conditions as may, in the opinion of the Tribunal, be just and equitable in the circumstances of the case;

(f) the termination, setting aside or modification of any agreement between the company and any person other than those referred to in clause (e):

(g) the setting aside of any transfer, delivery of goods, payment, execution or other act relating to property made or done by or against the company within three months before the date of the application under this section, which would, if made or done by or against an individual, be deemed in his insolvency to be a fraudulent preference;

(h) removal of the managing director, manager or any of the directors of the company;

(i) recovery of undue gains made by any managing director, manager or director during the period of his appointment as such and the manner of utilisation of the recovery including transfer to Investor Education and Protection Fund or repayment to identifiable victims;

(j) the manner in which the managing director or manager of the company may be appointed subsequent to an order removing the existing managing director or manager of the company made under clause (h);

(k) appointment of such number of persons as directors, who may be required by the Tribunal to report to the Tribunal on such matters as the Tribunal may direct;

(l) imposition of costs as may be deemed fit by the Tribunal;

(m) any other matter for which, in the opinion of the Tribunal, it is just and equitable that provision should be made.
Case Law: Petitioner having been removed as director of respondent company without holding of valid EOGM and entire shareholdings of respondents as well as fixed assets of companies having being transferred to 3rd parties even before completion of pleadings in NCLT, without knowledge of petitioner, were serious act of oppression, hence, findings of NCLT upholding removal of petitioner as director were to be set aside and shareholdings in both companies were to be restored to stage of filing petitions. [Pinakin Kharwar v. Nagina Processors (P.) Ltd.⁹, Company Appeal (at) Nos. 400 & 403 of 2017 I.A. NOS. 173 & 174 OF 2018, May 28, 2018]

Class Action Suit: American depositors of Satyam were able to receive $125 million in settlement because of strong framework of class action in USA while Indian investors lost all their money. Hence Companies Act, 2013 vide Section 245 has introduced the new concept of class action suit. This section gives additional rights to minorities in case of oppression and mismanagement. A class action is a legal proceeding in which shareholders bring suit as a group against the company or its directors or officers and the judgment or settlement received from the suit covers all the shareholders equally.

For companies with a share capital, 100 members or 10% shareholders whichever is less or member(s) holding at least 10% shareholding in the company and for a company without share capital, 1/5th total members can collectively approach the NCLT if they find that the company’s affairs are not being managed in its best interests for redressing the situation. Shareholders may exercise their rights if they are of the opinion that the management or conducts of the affairs of the company are being conducted in a manner prejudicial to the interests of the company to prevent:

(a) the company from committing an act which is ultra vires the articles or memorandum of the company;
(b) to restrain the company from committing breach of any provision of the company’s memorandum or articles;
(c) to declare a resolution altering the memorandum or articles of the company as void if the resolution was passed by suppression of material facts or obtained by mis-statement to the members or depositors;
(d) to restrain the company and its directors from acting on such resolution;
(e) to restrain the company from doing an act which is contrary to the provisions of this Act or any other law for the time being in force;
(f) to restrain the company from taking action contrary to any resolution passed by the members.
(g) to claim damages or compensation or demand any other suitable action from or against—
(h) the company or its directors for any fraudulent, unlawful or wrongful act or omission or conduct or any likely act or omission or conduct on its or their part;
(i) the auditor including audit firm of the company for any improper or misleading statement of particulars made in his audit report or for any fraudulent, unlawful or wrongful act or conduct; or
(j) any expert or advisor or consultant or any other person for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part;
(k) to seek any other remedy as the Tribunal may deem fit.

⁹ [2018] 96 taxmann.com 36 (NCL-AT)
Further they can claim damages or compensation for any misstatement, fraudulent, unlawful or wrongful act from

- the company or its directors
- Auditors and audit company (example: misleading statement in audit report)
- Advisors, Consultants, Experts

The cost or expenses connected with the application for class action shall be borne by the company or any other person responsible for any oppressive act.

With section 245, hopefully, in genuine cases of oppression minority shareholders will be empowered and will be able to come together to institute suits to protect their rights and will be able to claim damages as well from the company, directors, auditors, experts and advisors. An individual shareholder may find it difficult to file a suit against the company and even if he does so, may not be able to enforce his rights but may have a much better chance when filling a combined suit with similarly aggrieved shareholders.

The National Company Law Tribunal (NCLT) — in its order in the Cyrus Mistry versus Tata Sons case, which was released on July 12, 2018 while upholding the removal of Mistry as chairman has observed that:

“Whoever invested more shall have his say over the affairs of the company. ... It is obvious that minority sailing along with majority is bound by the rule of majority. Otherwise, it will become curtailment of the rights of major shareholders.”

GOVERNANCE OF CORPORATE GROUPS

Corporate Group: A corporate group or group of companies is a collection of holding and subsidiary corporations that function as a single economic entity through a common source of control. In India most big family businesses operate through a group of companies such as Tata group and Aditya Birla Group. Controlling a company means having the power to appoint the majority of its directors or significantly influence its decisions. The group may have a single holding company or be a network of companies through cross holdings. The control of company S by company H may be direct i.e. company H directly holds the majority of voting rights on the management board of company S or indirect i.e. H controls intermediate companies A, B, C, etc, which it can ask to vote the same way as the board of H, thereby obtaining a majority of rights in S. According to Sec 2(27) of the Companies Act 2013 (Act) “control shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or in any other manner”. In the above case H is the holding company and S the subsidiary company.

Holding Company: In terms of Section 2(46) "holding company", in relation to one or more other
companies, means a company of which such companies are subsidiary companies. The Explanation to this sub-section states that for the purposes of this clause, the expression "company" includes any body corporate.

A holding company is a parent company that owns enough voting shares in another company to control its policies and management. A holding company may have several subsidiaries and not carry on any business or operation on its own its purpose being to own other companies to form a corporate group.

**Subsidiary:** A subsidiary is a company when more than 50% shares controlled by another company, which is usually referred to as the parent company or the holding company.

According to Sec 2(87) of the Act “subsidiary company” or “subsidiary”, in relation to any other company (that is to say the holding company), means a company in which the holding company—

(i) controls the composition of the Board of Directors; i.e. at its discretion can appoint or remove all or majority of the directors

(ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

Subsidiary may be:

**Wholly Owned:** A wholly owned subsidiary is a company whose shares are 100% owned by another company, the holding company.

**Material Subsidiary:** Material subsidiary shall mean a subsidiary, whose income or net worth exceeds ten percent (10%) of the consolidated income or net worth respectively, of the listed company and its subsidiaries in the immediately preceding accounting year. [SEBI (Listing Obligation and Disclosure requirements), 2015 (LODR)]

It may be noted that the holding company may be a private company or unlisted and the subsidiary a listed company or the subsidiary may be unlisted and holding a listed company. Similarly an Indian Company may have a holding or subsidiary company that is a foreign company.

**Associate Company:** Companies within a group which do not have a holding –subsidiary relationship are known as associate companies. For instance two subsidiaries of the same holding company will be considered as an associate company. “Associate company, in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company”. (Sec 2(6))

**Legal Position:** Holding and subsidiary are separate and distinct legal entities. The employees of the subsidiary are not employees of the holding company. The holding company is not liable for the dues of the subsidiary. However a holding, subsidiary or an associate company will be treated as a related party of a company in terms of Section 2(76)(viii).

### Governance of Subsidiaries

Group companies create a complex organizational structure resulting in a complicated governance environment. Boards have a fiduciary duty to work in the best interest of the company. For the board of a holding company the question is to what extent should it be involved in the governance of its subsidiaries? To properly carry out its fiduciary role the board must act independently and objectively. The holding company often nominates its director or officers as directors on the subsidiary company. It is difficult for the board of the subsidiary to act in its own interest alone. If directors of subsidiaries act against wishes of the
controlling authority the risk being removed from the board. As a result the interest of the group or holding company gets priority over that of the subsidiary.

The board of the holding company needs to determine whether all companies will have a single governance structure or each subsidiary can determine their own governance systems. And how the parent board will monitor governance of the subsidiaries and what will be the extent of oversight. Subsidiaries may be categories in terms of level of investment, strategic importance and risk to the group and appropriate governance mechanism established.

In multinational groups with companies incorporated in different countries there is an additional problem of difference in laws and regulations. While local governance regulations are to be compiled by the subsidiary, its governance system must be aligned with the holding company for smooth functioning.

**MONITORING OF SUBSIDIARY COMPANIES IN INDIA**

To protect the interest of shareholders of holding company and minority shareholders of subsidiary certain provisions have been put in place both by the Companies Act, 2013 and SEBI (LODR).

**Board:** At least one independent director on the board of directors of the listed company shall be a director on the board of directors of any unlisted material subsidiaries including foreign companies. The minutes of the meetings of the board of directors of the unlisted subsidiary shall be placed at the meeting of the board of directors of the listed company. The management of the unlisted subsidiary shall periodically bring to the notice of the board of directors of the listed company, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary. Significant transaction or arrangement” shall mean any individual transaction or arrangement that exceeds or is likely to exceed ten percent (10%) of the total revenues or total expenses or total assets or total liabilities, as the case may be, of the unlisted material subsidiary for the immediately preceding accounting year. (Regulation 24)

Consolidated Financial Statements: If a company has one or more subsidiaries, associate companies or Joint Ventures, it shall prepare a consolidated financial statement of the company and of all the subsidiaries, associate companies and joint venture in the same form and manner as that of its own. In addition to the stand alone financial statements of the holding company, a consolidated financial Statement of holding company is to be published to disclose details about subsidiary, associate Companies and Joint ventures. (Sec 129) The Balance sheet of holding company shall specifically disclose investments in the subsidiaries. The Profit and Loss account of Holding company shall disclose (a) Dividends from subsidiary Companies and (b) Provisions for losses of subsidiary Companies. (Schedule III) The holding Company is required to: (a) Place separate audited accounts in respect of each of its subsidiary on its website and (b) Provide a copy of separate audited financial statements in respect of each of its subsidiary, to any shareholder of the Company who ask for it. (Section 136)

On the other hand the balance sheet of subsidiary company should disclose shares held by its holding company or its ultimate holding Company, or subsidiaries and associates of the holding company and the ultimate holding Company. (Schedule III)

**Audit and Audit Committee:** The statutory auditor of a listed entity shall undertake a limited review of the audit of all the entities/ companies whose accounts are to be consolidated with the listed entity. Besides audited annual consolidated statements at least eighty percent of the quarterly consolidated financial results, of each of the consolidated revenue, assets and profits, respectively, shall have been audited or subjected to limited review. (Regulation 33)

The audit committee of the listed company shall also review the financial statements, of subsidiaries in
particular, the investments made by the unlisted subsidiary. (Regulation 24) The board of a holding company can authorize anyone to inspection of books of account of any subsidiary company. (Section 128)

**Material Subsidiary:** The listed company shall not dispose of shares in its material subsidiary which would reduce its shareholding (either on its own or together with other subsidiaries) to less than 50% or cease the exercise of control over the subsidiary without passing a special resolution in its General Meeting. Exception has been granted for divestment under a scheme of arrangement duly approved by a court/tribunal. (Regulation 24)

Selling, disposing and leasing of assets amounting to more than twenty percent (20%) of the assets of the material subsidiary on an aggregate basis during a financial year shall require prior approval of shareholders by way of special resolution, unless the sale/disposal/lease is made under a scheme of arrangement duly approved by a Court/Tribunal. (Regulation 24)

Every listed entity's material unlisted subsidiaries incorporated in India shall undertake secretarial audit and shall annex the report with its annual report. (Regulation 24A) This will help improve compliance of group as a whole.

The policy on material subsidiary shall be disclosed in the company's web site and in the annual report of the company or a web link provided in the annual report. These regulations ensure that shareholders of the holding company can monitor subsidiaries who performance affects the performance of their company even if they are unlisted.

**FINANCIAL OVERSIGHT**

Corporate governance came to the forefront due to scams such as Maxwell in UK, Enron in US and Satyam in India. In each of these cases executives were able to con investors by manipulating and falsifying financial accounts of the company. The auditors of the companies were either negligent or an accomplice in allowing incorrect and misleading financial statements to be issued. Therefore the Cadbury Committee recommended increasing auditors' effectiveness, setting up an audit committee to provide financial oversight and strengthen financial reporting standards for improved disclosures.

**Auditors’ Effectiveness**

Auditors are responsible for evaluating the validity and reliability of the company's financial statements. Statutory auditors are independent accounting professionals that audit the financial statements on behalf of the shareholders to make sure they provide a true and fair presentation of the financial status of the company. Thus it is the shareholders who appoint auditors in the Annual General Meeting.

The auditors must be a chartered accountant or a chartered accountant firm and they must carry out their work with professional objectivity and due care. They should maintain a professional and independent relationship with the management. Hence Companies Act, 2013 has introduced several new provisions with reference to auditors.

**Auditor’s Independence**

To maintain independence of the auditors the following cannot be appointed Auditors (Section 141):

1. An officer or employee of the company.
2. A person who is partner or who in the employment, of an officer or employee of the company.
3. A person who or his relative or partner
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(a) Who is holding any security or interest in the company or the subsidiary or the holding? Anyway latest can hold security or interest in the company of the face value which should not exceed Rupees 1 lakh.

(b) Who has indebted to the company or a subsidiary to hold and Associate Company is subsidiary or such holding company.

(c) Who has provided the guarantee for any security in the connection with if the indebtedness of any third person of the company arises.

4. “A person or a firm who (whether directly or indirectly) has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company”.

5. A person whose relative is a director or is in the employment of the company as a director or any other key managerial post.

6. A person who is in full time employment elsewhere or a person or a partner of a firm holding employment as its auditor, if such person or partner is at the date of such appointment, holding appointment as auditor of more than 20 companies.

7. A person who has been convicted by the court of an offence involving fraud and a period of 10 years has not elapsed from the date of such conviction.

8. Any person whose subsidiary or associate company or any other form of entity is engaged as on the date of appointment in consulting and specialized services as provided in Section 144 (auditors not to render certain services).

Rotation of Auditors: It was found that auditors continue in the same company for years and years. This can result in a close relationship developing between management and auditors increasing the chances of fraud. Both Enron and Satyam saw this happen. Hence section 139 requires mandatory rotation of auditors. An individual cannot act as an auditor for more than five consecutive years and an audit firm can be appointed as auditor for not more than two terms of five consecutive years each. Once the term is ended they cannot be reappointed a period of five years. The new firm to be appointed must also not have a common partner with the earlier firm. It is advisable for the company to regularly rotate the partners of the firm who are auditing the company. They may consider appointing more than one auditor to reduce risk of audit inefficiency. However joint audit has its own inherent risks.

Case Law: Where company appointed petitioner-Chartered Accountant (CA) firm as its Statutory Auditor for period of five years but did not ratify their appointment in its subsequent Annual General Meeting and appointed another CA firm as its statutory auditor, since company did not obtain prior approval of central Government, removal of petitioner was to be held illegal AGM. [SPC & Associates, Chartered Accountants v. DVAK & Co.10, CP NO. 21/140/HDB/2016, March 17, 2017]

According to Rule 5 of the Companies (Audit and Auditors) Rules, 2014 (Audit Rules) rotation of auditors applies to the following classes of companies excluding one person companies and small companies:

- All unlisted public companies having paid-up share capital of ₹10 crore or more
- All private limited companies having paid-up share capital of 20 crore or more

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10 [2017] 80 taxmann.com 48 (NCLT - Hyd.)
All public and private limited companies having a paid-up share capital of less than the threshold limit set out above but having aggregate public borrowings from financial institutions, banks or public deposits of Rs. 50 crore or more.

**Auditor’s Remuneration and Non- Audit Services:** Though Companies Act, 2013 does not specify any restrictions on auditor’s remuneration it should be reasonable, adequate but not excess, keeping the scope of the audit and auditors capabilities in mind. Excess Remuneration is an incentive to retain the client and reduces their objectivity. Non-audit services may affect the independence of the auditor hence the following are prohibited under Section 144.

(a) accounting and book keeping services;
(b) internal audit;
(c) design and implementation of any financial information system;
(d) actuarial services;
(e) investment advisory services;
(f) investment banking services;
(g) rendering of outsourced financial services;
(h) management services; and
(i) any other kind of services as may be prescribed.

**National Financial Reporting Authority (NFRA)**

The NFRA is an independent regulator established under Section 132 of the Companies Act, 2013 to oversee the auditing profession. It is similar to the Public Company Accounting Oversight Body set by in the USA by the Sarbanes Oxley Act 2002.

The need for establishing NFRA has arisen on account of the need felt across various jurisdictions in the world, in the wake of accounting scams, to establish independent regulators, independent from those it regulates, for enforcement of auditing standards and ensuring the quality of audits to strengthen the independence of audit firms, quality of audits and, therefore enhance investor and public confidence in financial disclosures of companies. (Cabinet approves Establishment of A National Financial Reporting Authority, Press Information Bureau, Government of India, Cabinet, 01-March-2018)

**Powers and Functions of NFRA**

(A) NFRA may investigate either suo-motu or on a reference made by the Central Government in matters of professional misconduct committed by any member or Chartered Accountants firm.

(B) To make recommendations to the Central Government on formulation and laying down of accounting standards and auditing policies for adoption by companies or their auditors.

(C) To monitor and implement compliance relating to accounting standards and auditing policies as prescribed.

(D) To oversee the quality of service of professions associated with compliance of accounting standards and auditing policies and suggest measures for improvement
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(E) NFRA shall have equivalent powers as a civil court under the Code of Civil Procedure, 1908. It can exercise the powers related to:-

(i) discovery and production of books or other documents as specified by NFRA;
(ii) summoning and enforcing the attendance of persons and examining them on oath;
(iii) inspection of books, registers and other documents of any person;
(iv) issuing commissions for examination of witness or other documents.

(F) NFRA may impose penalties:

(i) not less than one lakh rupees which may extend up to five times of the fees received in case of individuals and
(ii) not less than ten lakh rupees which may extend up to ten times of the fees received in case of firms.

(G) NFRA may consider an investigation based on monitoring and compliance review of auditor or audit firm upon recommendations by Member- Accounting and Member- Auditing.

(H) NFRA shall receive a final report from the Committee on Enforcement on matters referred to them and issue a notice in writing to the investigated company or the professional on whom the action is proposed to be taken.

(I) NFRA may conduct quality review of the following class of companies:-

(a) Listed companies,
(b) Unlisted companies having net worth or paid up capital of not less than 500 crores or annual turnover of not less than 1000 crores as on 31st March of immediately preceding financial year,
(c) Companies having securities listed outside India.

(J) NFRA may debar any member or a firm from engaging himself or itself from practice as a member of the Institute of Chartered Accountants of India for a minimum period of six months which may extend upto ten years on account of proved misconduct.

(K) NFRA shall have the power to accept or overrule clarifications received or objections raised in writing.

(L) NFRA may investigate against the auditor or audit firms which conducts-

(a) audit of 200 or more companies in a year,
(b) audit of 20 or more listed companies

AUDIT COMMITTEE

Audit Committee is a board committee consisting of minimum three directors responsible for reviewing financial statements and ensuring independence of auditors. It is important that the audit committee be predominately independent so that the management cannot influence its functioning. An independent audit committee will be in a better position to ensure that the financial statements are true and fair. Both Companies Act (Act) 2013 and Listing Obligations and Disclosure Requirements (LODR), 2015 expect the audit committee to pay a significant role in ensuring good governance in companies. The requirement of the chairman of the audit committee to attend the annual general meeting and answer shareholder queries puts onus on the audit committee to protect shareholders from fraudulent reporting.
Companies required to have an audit Committee

Sec 177 of the Act along with Companies (Meetings of Board and its Powers) Rules, 2014 requires that following companies to have an audit committee:

1. All listed Companies
2. Public companies which fulfil one of the following Criteria
   (i) a paid up capital of ₹10 Crores or more;
   (ii) turnover of ₹100 Crores or more;
   (iii) Having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding ₹50 Crores or more.

   The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account

Composition of Audit Committee:

The composition of the Audit Committee as per Companies Act, 2013 and as per SEBI (LODR) 2015 is as under:

As per Sec 177 of Companies Act:

- Minimum three directors
- Independent directors to form majority (except charitable companies under Sec 8)
- The Chairperson and majority of members of Audit Committee should be able to read and understand the financial statement.

The Board’s report under section 134(3) shall disclose the composition of an Audit committee.

As per Regulation 18 of chapter IV of LODR:

- Minimum three directors
- Two-third of the members to be independent
- The chairperson of the audit committee shall be an independent director
- All members of Audit Committee should be financial literate (able to read and understand the financial statement) an at least one should have accounting or financial expertise.
- The Company Secretary shall act as the secretary to the audit committee.
- The audit committee at its discretion shall invite the finance director or head of the finance function, head of internal audit and a representative of the statutory auditor and any other such executives to be present at the meetings of the committee

It may be noted that all listed companies are required to comply with LODR.

Meeting of the Audit Committee: The audit committee shall meet at least four times in a year and not more than one hundred and twenty days shall elapse between two meetings. Sometimes the audit committee should meet without the presence of any executives of the company

The quorum for audit committee meeting shall either be two members or one third of the members of the audit committee, whichever is greater, with at least two independent directors.
Role of Audit Committee: The board should specify in details and in writing the scope of the audit committee and may decide additional responsibilities besides those defined by law. The role of the audit committee is covered by Sec 177 of the Act and Part C of Schedule II of LODR, 2015.

Review Accounting Processes and Financial statements: A primary role of the audit committee is to ensure that the accounting processes and internal control systems are robust enough to prevent and detect fraud. In consultation with internal and statutory auditors the committee is to evaluate the internal financial controls and risk management systems and if needed take steps to strengthen them. They are to examine the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.

They are to review the financial statements, both annual and quarterly particularly with reference to:

- Changes, if any, in accounting policies and practices and reasons for the same
- Major accounting entries involving estimates based on the exercise of judgment by management
- Significant adjustments made in the financial statements arising out of audit findings
- Compliance with listing and other legal requirements relating to financial statements

The committee should examine the auditors’ report and their observations and can discuss any matter with internal and statutory auditors or the management of the company before their submission to the Board.

Oversight of Auditors: The committee must reviewing the adequacy of internal audit function, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure, coverage and frequency of internal audit to make sure that the internal auditors are functioning satisfactory.

To ensure independence and effectiveness of statutory auditors the audit committee will review and monitor the auditor’s independence, the audit scope and process, and performance of the audit team and accordingly recommend appointment, remuneration and terms of appointment of auditors of the company.

Related Party Transactions (RPT): The audit committee is to approve all related party transactions or their modifications. They are to give their recommendation to the board are examining the proposed RPT with respect to the:

- Nature of the relationship
- Nature, particulars and duration of contract or arrangement
- Material terms and value of contract/arrangement
- Manner of deciding pricing & other terms included in contract
- Any other important factors influencing the decision

The audit committee may give omnibus approval for RPTs specifying the criteria for approval, such as

(a) maximum value of the transactions, in aggregate, which can be allowed under the omnibus route in a year;
(b) the maximum value per transaction which can be allowed;
(c) extent and manner of disclosures to be made to the Audit Committee at the time of seeking omnibus approval;
(d) review, at such intervals as the Audit Committee may deem fit,
(e) transactions which cannot be subject to the omnibus approval by the Audit Committee.

Before giving omnibus approval the Audit Committee shall consider the

(a) repetitiveness of the transactions (in past or in future);
(b) justification for the need of omnibus approval.

And shall give approval after satisfy itself on the need for omnibus approval for transactions of repetitive nature and that such approval is in the interest of the company.

The omnibus approval shall be for a maximum period of one year and indicate the following:

(a) name of the related parties;
(b) nature and duration of the transaction;
(c) maximum amount of transaction that can be entered into;
(d) the indicative base price or current contracted price and the formula for variation in the price, if any;
(e) any other information relevant or important for the Audit Committee to take a decision on the proposed transaction:

Where is it not possible to determine exact details audit committee may make omnibus approval for such transactions subject to a maximum of rupees one crore. Omnibus approval shall be valid for a period not exceeding one financial year and shall require fresh approval after the expiry of such financial year. Omnibus approval shall not be made for transactions in respect of selling or disposing of the undertaking of the company.

Financial Propriety: In additional to related party transactions to ensure that company executives are not manipulating statements or misappropriating funds the audit committee is to undertake:

- scrutiny of inter-corporate loans and investments;
- valuation of undertakings or assets of the company, wherever it is necessary;
- monitoring the end use of funds raised through public offers and related matters; and
- examine the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.

The audit committee is to approve the appointment of Chief Financial Officer after assessing the qualifications, experience & background, etc. of the candidate. This enables the audit committee to make sure the right person takes care of the financials of the company. The audit committee has a pivotal role to play in the board’s financial oversight of the company. To carry out its activities the committee has access to all the company records and authority to investigate into any related matters and if needed obtain professional advice from external sources. Where the Board had not accepted any recommendation of the Audit Committee, the same shall be disclosed in the board’s report along with the reasons there for.

STRENGTHENING FINANCIAL REPORTING STANDARDS

Better financial standards are required to reduce scope for management and auditor’s discretion in preparing financial statements. To improve financial reporting standards India has revised its accounting standards in line with the International Financial Reporting standards. The new Ind-AS developed by the Accounting Standards Board of India is convergent with IFRS. More disclosures are required under Ind-AS as compared to earlier standards. The new standards emphasize fair value and transparency and will go a long way in better financial reporting. NFRA is further expected to further strengthen accounting and auditing standards
so that shareholders and other stakeholders are well informed and can take appropriate decisions to protect their investments.

**CONCLUSION**

Promoters have an important and fiduciary role in the company and its growth. Controlling power may lead to misuse of their rights leading to oppression of minority shareholders and mismanagement of the company at the cost of minorities’ interest. Companies Act 2013 has put in place several safeguards to protect the interest of minority shareholders. It is important for small and minority shareholders to actually exercise their rights to protect their interests.

The corporate scams including the PNB fraud have highlighted the need to have robust financial systems. As auditors have failed again and again to prevent accounting frauds the NFRA has been set up to regulate them. Additionally companies are to set up an audit committee to provide financial oversight, oversee audit function and ensure fair and correct financial statements are issued. However the role of shareholders’ should not be undermined. They must exercise their rights and select the right kind of auditors and directors who will work in the best interest of the company and the shareholders.

**GLOSSARY OF TECHNICAL WORDS**

- **Majority Shareholder**: is a shareholder who alone or in combination with others controls a majority of the outstanding shares in a company
- **Minority Shareholder**: a shareholder whose proportion of shareholding is too small to confer any power to exert control or influence any action of the company
- **Mismanagement**: simply means inefficient or careless management of a company's affairs.

**LESSON ROUND UP**

- Promoter(s) takes the initiative to form a company and start a business.
- The role of the promoter is (i) incorporation of the company (ii) Fiduciary role to not make any secret profit and to disclose to the company any interests which he has in a transaction entered into by it (iii) to Execute pre-incorporation contracts if needed
- When a promoter commits a breach of duties the company may either rescind the contract, or recover any secret profits earned by the promoter.
- Promoter is defined in Companies Act as anyone who is specifically named so or who directly or indirectly controls the company affairs or board of directors. It lays down liabilities on promoters for violating provisions or the act, incorrect, misleading or false information or for any fraudulent act
- When an individual, organization or group of shareholders together hold or control more than 50% shares of the company they are known as majority shareholders. If a company has a majority shareholder then all other shareholders become minority shareholders.
- Minority Shareholders have all the rights of the shareholders. i.e. to participate in the profits of the corporation: information about the corporation; right to participation in general shareholder meetings and influence corporate actions through voting on proposals.
- To prevent exploitation by majority special rights are provided to minority shareholder.
- Special rights of minority shareholders include
  - Appointment of director by small shareholders
  - Facility of Electronic voting
• Exit Rights when majority control 90% or more
• Monitor and even block related party transactions not done at arm’s length
• Relief in case of oppression and mismanagement
• Class Action Suit

• Required number of shareholders may apply to NCLT for relief from oppression or mismanagement if the company is being conducted or likely to be conducted in a manner prejudicial to shareholders, the company or public interest. The Tribunal may pass suitable order to provide relief to minority shareholders.
• Shareholders may file a class action suit to prevent oppression and mismanagement or claim damages from the directors, auditors, consultants for any misstatement, fraudulent, unlawful or wrongful act
• A balance is to be struck between the rule of the majority and the rights of the minority.
• A corporate group or group of companies is a collection of holding and subsidiary corporations that function as a single economic entity through a common source of control
• Control implies the right to appoint majority of the directors or to control the management or policy decisions
• A holding company is a parent company that owns enough voting shares in another company to control its policies and management.
• Subsidiary means a company in Material subsidiary shall mean a subsidiary, whose income or net worth exceeds ten percent (10%) of the consolidated income or net worth respectively, of the listed company and its subsidiaries in the immediately preceding accounting year
• The board of the holding company needs to determine whether all companies will have a single governance structure or each subsidiary can determine their own governance systems. The parent board needs to decide the extent of oversight and devise mechanisms to monitor governance of the subsidiaries.
• Measures taken in India to monitor Subsidiaries
  ▪ At least one independent director on the board of directors of the listed company shall be a director on the board of directors of an unlisted material subsidiary including foreign company.
  ▪ The minutes of the meetings of the board of directors of the unlisted subsidiary shall be placed at the meeting of the board of directors of the listed company.
  ▪ A consolidated financial Statement of holding company is to be published to disclose details about subsidiary, associate companies and joint ventures.
  ▪ The statutory auditor of a listed entity shall undertake a limited review of the audit of all the companies whose accounts are to be consolidated with the listed entity.
  ▪ The audit committee of the listed company shall review the financial statements of subsidiaries in particular, the investments made by the unlisted subsidiary.
  ▪ The listed company shall not dispose of shares in its material subsidiary which would reduce its control over the subsidiary or sell or dispose off 20% of the assets of the material subsidiary without prior approval of shareholders by way of special resolution in an AGM.
  ▪ Material Indian unlisted subsidiaries of listed company to undertake secretarial audit
• Corporate Scams created the need to increasing auditors’ effectiveness, setting up an audit committee and strengthen financial reporting standards.
• Auditors are professional accountants who assure shareholders reliability of financial statements.
• Auditors’ effectiveness is enhance through
  ▪ Encouraging Professional Objectivity
  ▪ Maintaining Independence
  ▪ Rotation of Auditors
Lesson 10  Promoters and Minority Shareholders

- Appropriate Remuneration
- Restriction on Non-Audit Services

- Section 139 requires mandatory rotation of auditors. An individual cannot act as an auditor for more than five consecutive years and an audit firm can be appointed as auditor for not more than two terms of five consecutive years each. Once the term is ended they cannot be reappointed a period of five years.

- The National Financial Reporting Authority is an independent regulator established under Sec 132 of the Act to oversee the auditing profession, improve the quality of audit and ensure independence of audit firms.

- Audit Committee is a board committee set up to provide financial oversight.

- The audit committee of a listed company is to be constituted as follows:
  - Minimum three directors
  - Two-third of the members to be independent
  - The chairperson of the audit committee shall be an independent director

- All members of Audit Committee should be financial literate (able to read and understand the financial statement) an at least one should have accounting or financial expertise.

- Role of Audit Committee
  - Review Accounting Processes and Financial statements including internal control systems, risk management mechanism and any frauds.
  - Review adequacy of internal audit function and independence and effectiveness of statutory auditors
  - The audit committee is to approve all related party transactions or their modifications.
  - Scrutinize major or unusual financial transactions or use of funds
  - Approve appointment of CFO

- To improve financial reporting standards India has revised its accounting standards. The new Ind-AS is in line with the International Financial Reporting standard.

REFERENCE FOR FURTHER READING


SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Comment on the importance of promoter in formation of the company?
2. Examine the legal position of promoters
3. Who is majority shareholder? What are concerns associated with a majority shareholder?
4. What measures can minority shareholders take to protect their interest?
5. Should “Majority Rule must prevail”. Critically evaluate
6. What are the special governance concerns of corporate groups?
7. What is meant by “material” subsidiary? What are the regulatory requirements in regard to them?
8. Why are consolidated financial statements prepared? Briefly describe the provisions in this regard?
9. What do you understand by financial oversight? Why is it needed?
10. Suggest some measures to increase auditors’ effectiveness?
11. What are the functions of NFRA?

12. Critically evaluate: “Audit Committee is central to good corporate Governance”

Lesson 11
Risk Management

LESSON OUTLINE

- Introduction
- Risk Management
- Risk Identification
- Risk Analysis
- Risk Assessment
- Risk Mitigation
- Classification of Risk
- Risk Management and Corporate Governance
- Standard on Implementation of Risk Management
- Fraud Risk Management
- Reputation Risk Management
- Responsibility of Risk Management
- Risk Governance
- Glossary
- Lesson Round-UP
- Self Test Questions

LEARNING OBJECTIVES

This study lesson explains the concepts, process, its advantages and steps for implementation of risk management. It also deals with the fraud and reputation risk management and how the negative reputation of an entity may have adverse impact on the operations and profitability.

The objective of this study lesson is to enable the students to understand risk management framework, the definition and types of risks; risk management process; advantages of risk management; steps in risk management; legal provisions on risk management; who is responsible for risk management etc.

This chapter may be useful in performing the advisory role in Risk Management and Risk Governance.

“The biggest risk is not taking any risk... In a world that’s changing really quickly, the only strategy that is guaranteed to fail is not taking risks.”

Mark Zuckerberg
INTRODUCTION

Risk and reward go hand in hand. We have often heard the statement that without risk there is no gain. Risk is inherent in the business. Different types of risk exist in the business according to the nature of the business and they are to be controlled and managed. Better risk management techniques provide early warning signals so that the same may addressed in time. In traditional concept the natural calamities like fire, earthquake, flood, etc. were only treated as risk and keeping the safe guard equipments etc. were assumed to have mitigated the risk. But due to rapid changes, the various types of risks have emerged viz. compliance risk, legal risk, country risk, operational risk (which we will discuss in this chapter). So in the ear of fast changing global economy, multiplicity of legal compliances, cross border business transactions and to ensure the survival, viability and sustainability of business, the management of the various types of risks have gained utmost importance.

Definition of Risk: 1A probability or threat of damage, injury, liability, loss, or any other negative occurrence that is caused by external or internal vulnerabilities, and that may be avoided through preemptive action.

RISK MANAGEMENT

What is Risk Management? It is not a particular event management rather it is a continuous process of identifying, evaluating and assessing the inherent and potential risk, adopting the methods for its systematic reduction in order to sustainable business development.

Risk is inherent in every business, whether it be of financial nature or non-financial nature. Thus, management of the risk is very important. Risk management begins with the risk identification, analyzing the risk factors, making assessment of the risk and mitigation of the risk (which may be either the risk avoidance, risk reduction, risk optimization, risk sharing or finally risk retention).

To effectively manage risk, and seize the opportunity within every challenge, institutions must manage a variety of business dimensions. In today’s world they must focus on maximizing digital capabilities, building ongoing expertise, driving fluid collaboration, developing top-notch analytics and fostering a risk culture that can withstand disruptive change. Turn unknown risk into opportunities to newly tap possibility by preparing your people, activities and services for the path ahead.

Better risk management techniques provide early warning signals so that the same may addressed in time. In traditional concept the natural calamities like fire, earthquake, flood, etc were only treated as risk and keeping the safe guard equipments etc were assumed to have mitigated the risk. But due to rapid changes in the technologies, business dimensions and complexities, regulatory changes and environmental concerns, new and various types of risks have emerged. So in the era of fast changing global economy, multiplicity of legal compliances, cross border business transactions and to ensure the survival, viability and sustainability of business, the management of various types of risks have gained utmost importance.

Risk management requires commitment from the top management. It is no longer discretion. It is a tool necessary to have for creating opportunities for the businesses as they develop during the risk management process. Thus, Risk Management Process provides a framework to:

1. Ensure that all the foreseeable risks involved are actually understood and accepted before important decisions are taken.

1 http://www.businessdictionary.com/definition/risk.html
2. Monitor new projects and ongoing operations to ensure that they continue to develop satisfactorily and no problems or new risks emerge.

It is desirable to have a holistic approach to risk management that avoids compartmentalization of risks.

Risk Management is part of the corporate strategy. It is a key management tool to safeguard the business assets for its use for the productive purposes. Risk Management is a logical and systematic process of establishing the context, identifying, analysing, evaluating, treating, monitoring and communicating risks associated with any activity, function or process, in a way that enables an organisation to minimise losses and maximise opportunities.

We take an example of a Forex Department of a bank. How the Forex Department keep a track on the currency risk since it is very much volatile. It uses the sophisticated techniques like, Dealer exposure limit, over the night exposure limit, hedging, merchant wise exposure limit, Value at Risk (VaR) etc to keep the risk within the manageable limits.

Risk may be controllable or uncontrollable. In other words, the systematic risk which stands at macro level is not controllable, but the unsystematic risk which is at micro level is controllable with the risk mitigation techniques.

The process of risk management may be studied by risk identification, risk analysis, risk assessment and finally risk mitigation.

### RISK IDENTIFICATION

Risk identification is the first stage of the risk management strategy. By risk identification the organization is able to study the activities and places where its resources are placed to risk. Correct risk identification ensures effective risk management. If risk managers do not succeed in identifying all possible losses or gains that challenge the organization, then these non-identified risks will become non manageable. The first task of the risk management is to classify the corporate risks according to their different types. The first step in organizing the implementation of the risk management function is to establish the crucial observation areas inside and outside the corporation. Then, the departments and the employees must be assigned with responsibilities to identify specific risks.

The results of risk identification are normally documented in a risk register, which includes a list of identified risks along with their sources, potential risk responses and risk categories. This information is used for risk analysis, which in turn will support creating risk responses. Identified risks can also be represented in a risk breakdown structure - a hierarchical structure used to categorize potential project risks by source.

Though the major work on risk identification is usually done in the beginning of a project, it is important to remember that risk identification is an iterative process; new risks can be identified throughout the project life cycle as the result of internal or external changes to a project.

### Purpose

The objective of the risk identification process is to ensure that all potential project risks are identified. The strategies for dealing with these risks will be devised during later risk management steps.

The ultimate purpose of risk identification is to minimize the negative impact of project hiccups and threats, and to maximize the positive impact of project opportunities. Awareness of potential project risks reduces the number of surprises during the project delivery and, thus, improves the chances of project success, allowing the team to meet the time, schedule and quality objectives of the project.
Finally, the purpose of risk identification is to provide information for the next step of the risk management process.

**Example:**

Let's try to identify potential risks for the website development project. To carry out risk identification, one might want to involve the project team and hold a brainstorming session. Combining the experience of different team members will decrease the probability of omitting an important risk. Additionally, if the company already has carried out similar development projects, then the team will be able to utilize the risk checklists and lessons learned from previous projects.

### Process of Risk Identification

The process for risk identification starts by taking inventory of the potential project risks that can affect the project delivery. This step is crucial for efficient risk management throughout the project. The outputs of the risk identification are used as an input for risk analysis, and they reduce a project manager's uncertainty. It is an iterative process that needs to be continuously repeated throughout the duration of a project. The process needs to be rigorous to make sure that all possible risks are identified.

An effective risk identification process should include the following steps:

1. Creating a systematic process - The risk identification process should begin with project objectives and success factors.
2. Gathering information from various sources - Reliable and high quality information is essential for effective risk management.
3. Applying risk identification tools and techniques - The choice of the best suitable techniques will depend on the types of risks and activities, as well as organizational maturity.
4. Documenting the risks - Identified risks should be documented in a risk register and a risk breakdown structure, along with its causes and consequences.
5. Documenting the risk identification process - To improve and ease the risk identification process for future projects, the approach, participants, and scope of the process should be recorded.
6. Assessing the process' effectiveness - To improve it for future use, the effectiveness of the chosen process should be critically assessed after the project is completed.

### Seven Identification Essentials

Identification is a process of brainstorming. It isn’t an exact science and should involve continuous implementation as new phases, experiences, and viewpoints are introduced. Being vital to the management process, there are some essentials to risk identification that guarantee maximum results.

1. **Team Participation:**

   Face-to-face interactions between project managers and the team promise better and more comprehensive communication. The team must feel comfortable to share and find hidden or elusive risks.
2. Repetition

Information changes appear as the risk management process proceeds. Keeping identified risks current and updated means the system is focused on mitigating the most prevalent issues.

3. Approach

Certain objectives require distinct approaches to best combat identification failure. One method is to identify all root causes, undesirable events and map their potential impacts. Another is to identify essential performance functions the project must enact, then find possible issues with each function or goal. Both methods work well, but the latter may be easier due to its defined scope.

4. Documentation

Consistent and exhaustive documentation leads to comprehensive and reliable solutions for a specific project or future risk management team's analysis. Most communication is recorded by a project manager and data is copied, stored, and updated for continued risk prevention.

5. Roots and Symptoms

It is essential in the risk identification phase to find the root causes of a risk instead of mistaking them with the symptoms. A symptom can be confused with the root cause, making it critical to discover the origin of risks and denote what are their symptoms. Other essentials of risk identification involve the analysis phase. This is where identified risks are further researched and understood.

6. Project Definition Rating Index (PDRI)

PDRI is a risk assessment tool that helps develop mitigation programs for high-risk areas. It facilitates the team's risk assessment within the defined project scope, budget and deadlines. It also provides further detail of individual risks and their magnitude, represented by a score. The summation of scores is statistically compared to the project performance as a certainty level for the entire project.

7. Event Trees

Commonly used in reliability studies and probabilistic risk assessments, event trees represent an event followed by all factors and faults related to it. The top of the tree is the event and it is supported by any condition that may lead to that event, helping with likelihood visibility.

Risk identification is the first step towards risk minimization and understanding. If a risk isn't discovered in the first phase, it may be found and included later due to the nature of risk identification. It is a non-stop process involving teamwork and communication.

<table>
<thead>
<tr>
<th>SWOT Analysis</th>
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<tbody>
<tr>
<td>A useful tool for systematic risk identification is SWOT analysis. It consisting of four elements:</td>
</tr>
<tr>
<td>• Strengths - Internal organizational characteristics that can help to achieve project objectives.</td>
</tr>
<tr>
<td>• Weaknesses - Internal organizational characteristics that can prevent a project from achieving its objectives.</td>
</tr>
<tr>
<td>• Opportunities - External conditions that can help to achieve project objectives.</td>
</tr>
<tr>
<td>• Threats - External conditions that can prevent a project from achieving its objectives.</td>
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</tbody>
</table>
A sample SWOT analysis for launching a new all-natural iced drink.

Both opportunities and threats are risks that can have a positive or negative effect on a project, and each require risk responses.

**RISK ANALYSIS**

After identification of the risk parameters, the second stage is of analyzing the risk which helps to identify and manage potential problems that could undermine key business initiatives or projects.

To carry out a Risk Analysis, first identify the possible threats and then estimate the likelihood that these threats will materialize. The analysis should be objective and should be industry specific. Within the industry, the scenario based analysis may be adopted taking into consideration of possible events that may occur and its alternative ways to achieve the given target.

Risk Analysis can be complex, as it requires to draw on detailed information such as project plans, financial data, security protocols, marketing forecasts and other relevant information. However, it's an essential planning tool, and one that could save time, money, and reputations.

**Use of Risk Analysis**

- Risk analysis is useful in many situations:
- While planning projects, to help in anticipating and neutralizing possible problems.
- While deciding whether or not to move forward with a project.
- While improving safety and managing potential risks in the workplace.
- While preparing for events such as equipment or technology failure, theft, staff sickness, or natural disasters.
- While planning for changes in environment, such as new competitors coming into the market, or changes to government policy.
- When all the permutations-combinations of possible events/ threats are listed while analyzing the risk
parameters and the steps taken to manage such risks, the risk matrix is designed / popped-up before the decision making and implementing authority.

### How to Use Risk Analysis

To carry out a risk analysis, follow these steps:

1. **Identify Threats**

   The first step in Risk Analysis is to identify the existing and possible threats that one might face. These can come from many different sources. For instance, they could be:

   - **Human** – Illness, death, injury, or other loss of a key individual.
   - **Operational** – Disruption to supplies and operations, loss of access to essential assets, or failures in distribution.
   - **Reputational** – Loss of customer or employee confidence, or damage to market reputation.
   - **Procedural** – Failures of accountability, internal systems, or controls, or from fraud.
   - **Project** – Going over budget, taking too long on key tasks, or experiencing issues with product or service quality.
   - **Financial** – Business failure, stock market fluctuations, interest rate changes, or non-availability of funding.
   - **Technical** – Advances in technology, or from technical failure.
   - **Natural** – Weather, natural disasters, or disease.
   - **Political** – Changes in tax, public opinion, government policy, or foreign influence.
   - **Structural** – Dangerous chemicals, poor lighting, falling boxes, or any situation where staff, products, or technology can be harmed.

   A number of different approaches can be used to carry out a thorough analysis:

   - Run through a list such as the one above to see if any of these threats are relevant.
   - Think about the systems, processes, or structures used and analyze risks to any part of these.
   - Ask others who might have different perspectives. Ask for input from team members and consult others in the organization, or those who run similar projects.
   - Tools such as SWOT Analysis and Failure Mode and Effects Analysis can also help to uncover threats, while Scenario Analysis helps to explore possible future threats.

2. **Estimate Risk**

   Once the threats are identified, it is required to calculate both the likelihood of these threats being realized, and their possible impact.

   One way of doing this is to make best estimate of the probability of the event occurring, and then to multiply this by the amount it will cost to set things on the right track. This gives a value for the risk:

   
   \[
   \text{Risk Value} = \text{Probability of Event} \times \text{Cost of Event}
   \]
As a simple example, imagine that a risk has been identified that your rent may increase substantially. You think that there's 80 percent chance of this happening within the next year, because your landlord has recently increased rents for other businesses. If this happens, it will cost your business an extra Rs. 500,000 over the next year.

So the risk value of the rent increase is:

\[
0.80 \times 500,000 = 400,000
\]

You can also use a Risk Impact/Probability Chart to assess risk. This will help you to identify which risks you need to focus on.

**RISK ASSESSMENT**

After identifying the risk, the third step is to have an assessment of each of the risk in terms of quantitatively and qualitatively. In judging the quantitative aspects the tools of the statistical methods may be used. The management has to take the decision on each of the assessment of the risk so derived by the various departments of the organisations, since the raw data do not reveal the clear picture.

**RISK MITIGATION**

Risk mitigation is defined as taking steps to reduce adverse effects. Risk mitigation is the process by which an organization introduces specific measures to minimize or eliminate unacceptable risks associated with its operations. Risk mitigation measures can be directed towards reducing the severity of risk consequences, reducing the probability of the risk materializing, or reducing the organizations exposure to the risk.

**Strategies for Risk Mitigation**

There are four types of risk mitigation strategies that hold unique to Business Continuity and Disaster Recovery. It's important to develop a strategy that closely relates to and matches the profile of any company.

The risk mitigation step involves development of mitigation plans designed to manage, eliminate, or reduce risk to an acceptable level. Once a plan is implemented, it is continually monitored to assess its efficacy with the intent of revising the course-of-action if needed.

Once risks have been identified and assessed, the strategies to manage the risk fall into one or more of the following categories:

(i) **Transfer Risk:** Normally in projects assignments or multifaceted exercises, execution is fought with risks. Different agencies work together and these agencies take care to transfer risk in their areas to another agency which is better equipped to take care of a risk for a consideration. Here the concept of core competence curves in and whenever a particular agency, individual or a firm finds that it is dealing in an area where it does not have the core competence to deal with it seeks the help of another agency which has the specific core competence to transfer its own risk. The risk may be in the form of loss of reputation or sub quality performance and this risk is taken care of through transfer.

(ii) **Tolerate Risk or Risk Retention:** It is retention of the risk. It is accepting the loss when it occurs. True self insurance falls in this category. Risk retention is a viable strategy for small risks where the cost of insuring against the risk would be greater over time than the total losses sustained. All risks
that are not avoided, reduced or transferred are retained by default. This includes risks that are so large or catastrophic that they either cannot be insured against or the premiums would be infeasible.

War is an example since most property and risks are not insured against war, so the loss attributed by war is retained by the insured. Also any amount of potential loss (risk) over the amount insured is retained risk. This may also be acceptable if the chance of a very large loss is small or if the cost to insure for greater coverage amounts is so great it would hinder the goals of the organization too much.

(iii) Reduce Risk: By far the greater number of risks will belong to this category. The purpose of treatment is not necessarily to obviate the risk, but more likely to contain the risk to an acceptable level. Internal controls are actions instigated from within the organization (although their effects may be felt outside of the organization) which are designed to contain risk to acceptable levels.

Outsourcing could be an example of risk reduction if the outsourcer can demonstrate higher capability at managing or reducing risks. In this case companies outsource only some of their departmental needs. For example, a company may outsource only its software development, the manufacturing of hard goods, or customer support needs to another company, while handling the business management itself. This way, the company can concentrate more on business development without having to worry as much about the manufacturing process.

Modern software development methodologies reduce risk by developing and delivering software incrementally. Early methodologies suffered from the fact that they only delivered software in the final phase of development; any problems encountered in earlier phases meant costly rework and often jeopardized the whole project.

(iv) Avoid Risk: This method results in complete elimination of exposure to loss due to a specific risk. It can be established by either avoiding to undertake the risky project or discontinuance of an activity to avoid risk. This means that no risky projects are undertaken. Alternatively, a project may be abandoned midway to mitigate the risk while handling a project.

It is not performing an activity which could carry risk. An example would be not buying a property or business in order to not take on the liability that comes with it. Another would be not flying in order to not take the risk that the aeroplanes were to be hijacked. Avoidance may seem the answer to all risks, but avoiding risks also means losing out on the potential gain that accepting (retaining) the risk may have allowed. Not entering a business to avoid the risk of loss also avoids the possibility of earning profits.

(v) Combine Risk: When the business faces two or three risks the overall risk is reduced by combination. This strategy is suitable mainly in the areas of financial risk. Different financial instruments say, shares and debentures are taken in a single portfolio to reduce the risk.

(vi) Sharing Risk: Insurance is a method of sharing risk for a consideration. For example by paying insurance premium the company shares the risk with companies and the insurance companies themselves share their risk by doing re-insurance.

(vii) Hedging Risk: Exposure of funds to fluctuations in foreign exchange rates, prices etc., bring about financial risks resulting in losses or gain. The downside risk is often taken care.
MAINTAINING THE RISK STRATEGY

It has already been noted that the risk environment of any organization is constantly changing and developing, and that the priorities of objectives and the consequent importance of risks will shift and change. The risk management process is therefore a dynamic and ongoing one, not an issue for a one off exercise. The process has to allow for periodic review of risks and for consequent adjustment of the control response.

Whatever option is adopted, it is important that those charged with control of the risk management process should regularly review it. One useful technique for doing this is to actively review the risks associated with each of the key organizational objectives.

Suitable tools needs to be identified to assist with the task of keeping the risk strategy up to date. A key tool is the use of ongoing Control and Risk Self Assessment (CRSA) procedures. This procedure embeds review of risk and control into the organization at every level and uses the knowledge and experience of the staff that are closest to each function to assess the movement in risks and the appropriateness of control.

CLASSIFICATION OF RISK

According to controllability: Risk may be classified according to controllability, i.e Controllable risk and Uncontrollable risk. In other words, the controllable risk is categorised as Unsystematic Risk and uncontrollable risk is categorised as Systematic Risk. The concept of controllable and uncontrollable risk may be further explained as under:

1. **Systematic Risk:**
   - It is uncontrollable by an organisation.
   - It is not predictable.
   - It is of Macro nature.
   - It affects a large number of organisations operating under a similar stream.
   - It cannot be assessed in advance.
   - It depends on the influence of external factors on an organisation which are normally uncontrollable by an organisation.
   - The example of such type of risk is Interest Rate Risk, Market Risk, Purchasing Power Risk.

2. **Unsystematic Risk:**
   - It is controllable by an organisation.
   - It is predictable.
   - It is Micro in nature.
   - It affects the individual organisation.
   - It can be assessed well in advance and risk mitigation can be made with proper planning and risk assessment techniques.
   - The example of such risk is Business Risk, Liquidity Risk, Financial Risk, Credit Risk, and Operational Risk.
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<table>
<thead>
<tr>
<th>Systematic Risk</th>
<th>Unsystematic Risk</th>
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</thead>
<tbody>
<tr>
<td>This type of risk is associated with the whole market or market segment.</td>
<td>This type of risk is associated with a particular industry or security.</td>
</tr>
<tr>
<td>It is uncontrollable</td>
<td>It is controllable.</td>
</tr>
<tr>
<td>Systematic risk affects the overall market and is difficult to predict.</td>
<td>Unsystematic risk affects a particular industry hence it is easy to predict.</td>
</tr>
<tr>
<td>The systematic risk is a result of external and uncontrollable variables.</td>
<td>The unsystematic risk is the result of internal hence may be controllable.</td>
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(b) Unsystematic Risk:

- It is controllable by an organisation.
- It is predictable.
- It is Micro in nature.
It affects the individual organisation.

It can be assessed well in advance and risk mitigation can be made with proper planning and risk assessment techniques.

The example of such risk is Business Risk, Liquidity Risk, Financial Risk, Credit Risk, Operational Risk.


**Financial Risk**: The risk which has some financial impact on the business entity is treated as financial risk. These risks may be market risk, credit risk, Liquidity risk, Operational Risk, Legal Risk and Country Risk. The following chart depicts the various types of financial risks.

1. **Market Risk**: This type of risk is associated with market ups and down. It refers to the risk of loss arising from the change/volatility in the market prices or economic values which are the deciding factors for the pricing of the product/financial assets. The market risks may be Absolute Risk (when it can be measured in rupee/currency term) and Relative Risk (relative to benchmark index). Hence the market risk may be defined as the risk to a firm due to the adverse changes in interest rates, currency rates, equity prices and commodity prices.
(a) **Interest Rate Risk:** The financial assets which are connected with interest factors such as bonds/ debentures, faces the interest rate risk. Interest rate risk adversely affects value of fixed income securities. Any increase in the interest reduces the price of bonds and debts instruments in debt market and vice versa. So it can be said that the changes in the interested rates have an inverse relationship with the price of bonds.

(b) **Currency Risk:** The volatility in the currency rates is called the currency risk. These risks affect the firms which have international operations of business and the quantum of the risk depends on the nature and extent of transactions with the external market.

(c) **Equity Risk:** It means the depreciation in one’s investment due to the change in market index. Beta ($\beta$) of a stock tells us the market risk of that stock and it is associated with the day-to-day fluctuations in the market.

(d) **Commodity Risk:** This type of risk is associated with the absolute changes in the price of the commodity. Since commodities are physical assets, hence the prices are changed on account of the demand and supply factor.

2. **Credit Risk:** When a counter party is unable or unwilling to fulfil their contractual obligation, the credit risk arises. This type of risk is related to the probability of default and recovery date. Its effect is measured by cost of replacing cash flow if the other party defaults. For example, in case of loan given by a bank to the borrower and the borrower defaults in making payments of the instalments or due interest on the due date, is termed as credit risk.

Credit risk is most simply defined as the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms. The goal of credit risk management is to maximise a bank’s risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Banks need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. Banks should also consider the relationships between credit risk and other risks. The effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any banking organisation.

3. **Liquidity Risk:** The liquidity risk arises due to mis-matches in the cash flow i.e. absence of adequate funds in the market. Liquidity is altogether different from the word solvency. A firm may be in sound position as per the balance sheet, but if the current assets are not in the form of cash or near cash assets, the firm may not make payment to the creditors which adversely affect the reputation of the firm. The liquidity risk may be of two types, trading risk and funding risk.

(a) Trading Risk: It may mean the absence of the market liquidity i.e. inability to enter into derivative transactions with counter parties or make sales or purchase of securities.

(b) Funding Risk: It refers to the inability to meet the obligations by either borrowing or the sale of securities. It arises where the balance sheet of a firm contains illiquid financial assets which cannot be turned in to cash within a very short time.

4. **Operational /System/ Management Risk:** It arises due to inadequate systems, system capacities, system failure, obsolescence risk, management failure on account co-ordination, faulty control or human error. Some best practice against the operational risk includes clear separation of responsibilities with strong internal control and regular contingency planning.

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2. https://www.bis.org/publ/bcbs54.htm
5. **Legal Risk:** This risk arises when a counter party does not have the legal or regulatory authority to engage in the transactions. It also includes the compliance and regulatory risk like insider trading, market manipulations etc.

6. **Political/Country Risk:** Political risk may be on account of declaration of elections in the territory, area specific risk. The Country risk arises where the firm have its business operations abroad. This risk may arise due to out-break of war between countries, imposition of the ban on the business transaction of particular commodity/product.

**Non-Financial Risk:** This type of risk do not have immediate financial impact on the business, but its consequence are very serious and later may have the financial impact. This type of risk may include, Business/Industry & Service Risk, Strategic Risk, Compliance Risk, Fraud Risk, Reputation Risk, Transaction risk, Disaster Risk.

1. **Business/Industry & Services Risk:** Business risks implies uncertainty in profits or danger of loss and the events that could pose a risk due to some unforeseen events in future, which causes business to fail. Business risk refers to the possibility of inadequate profits or even losses due to uncertainties e.g., changes in tastes, preferences of consumers, strikes, increased competition, change in government policy, obsolescence etc. Every business organization contains various risk elements while doing the business. Such type of risk may also arise due to business dynamics, competition risks affecting tariff prices, customer relation risk etc.

2. **Strategic Risk:** Unsuccessful business plan since its inception may lead to strategic risk. For example, strategic risk might arise from making poor business decisions, from the substandard execution of decisions, from inadequate resource allocation, or from a failure to respond well to changes in the business environment.

3. **Compliance Risk:** This risk arises on account of non-compliance of breaches of laws/regulations which the entity is supposed to adhere. It may result to deterioration to public reputation, penalty and penal provisions.

4. **Fraud Risk:** Fraud is perpetrated through the abuse of systems, controls, procedures and working practices. It may be performed by the outsider or even from the insider. Often the most trusted employee attempt to do this. Fraud may not be detected immediately, but is still usually discovered by chance, but the detection should be proactive rather than reactive.

5. **Reputation Risk:** This type of risk arises from the negative public opinion. Such type of risk may arise from the failure to assess and control compliance risk and can result in harm to existing or potential business relationships.

6. **Transaction Risk:** Transaction risk arises due to the failure or inadequacy of internal system, information channels, employees integrity or operating processes.
7. **Disaster Risk**: On account of natural calamities like floods, fire, earthquake, man-made risks due to extensive exploitation of land for mines activity, land escalation, risk of failure of disaster management plans formulated by the company etc.

**Advantages of Risk Management**

Risk management plays vital role in strategic planning. It is an integral part of project management. An effective risk management focuses on identifying and assessing possible risks. The advantages of having risk management are as under:

- Risk Management always results in significant cost savings and prevents wastage of time and effort in firefighting. It develops a Robust contingency planning.
- It can help plan and prepare for the opportunities that unravel during the course of a project or business.
- Risk Management improves strategic and business planning. It reduces costs by limiting legal action or preventing breakages.
- It establishes improved reliability among the stakeholders leading to an enhanced reputation.
- Sound Risk Management practices reassure key stakeholders throughout the organization.
- Risk Management strongly favours for a focused internal audit programme.

**RISK MANAGEMENT AND CORPORATE GOVERNANCE**

Corporate governance concerns the relationships among the management, board of directors, controlling shareholders, minority shareholders, and other stakeholders. Good corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital. Incorporating risk management in corporate governance of an organisation is very important.

Risk management and corporate governance principles are strongly interrelated. An organization implements strategies in order to reach their goals. Each strategy has related risks that must be managed in order to meet these goals. Following strong corporate governance principles that focus on risk management allows organizations to reach their goals.

Risk governance includes the skills, infrastructure (i.e., organization structure, controls and information systems), and culture deployed as directors exercise their oversight. Good risk governance provides clearly defined accountability, authority, and communication/reporting mechanisms.

A process for risk management cannot be initiated unless there is a perception and knowledge of risk surrounding the business. Businesses evolve and are exposed to change dynamics of the external environment. Hence it is important to have the risk oversight function, as one of the areas of responsibility of the board of directors of any enterprise. The Board may form a separate committee to support the board function depending on the complexities of the business enterprise and the complexities associated with its transactions and events. It would also depend on the size and extent of delegation of responsibilities by the board of directors. While everyone understands that risk is all pervasive, risk management must be voiced from the top and the tone should indicate a serious approach by the top management. The board shall have to identify the extent and type of risks it faces and the planning necessary to manage and mitigate the same for ensuring growth for the benefit of all the stakeholders. Therefore, the Board has to define a risk philosophy and the extent to which it is willing to accept any consequence of taking of risks by the organization and its functionaries in its day to day functioning.
Board members need to have a good understanding of risk management, even when they lack expertise in that area. Boards may lean on the expertise of outside consultants to help them review company risk management systems and analyze business specific risks. Boards should perform a formal review of risk management systems, at least once a year.

As part of the annual review, boards should review risk oversight policies and procedures at the board and committee levels and assess risk on an ongoing basis. It's helpful to familiarize the board with expectations within the industry or regulatory bodies that the organization operates in by arranging for a formal presentation on risk management best practices. The annual risk management review should include communication from management about lessons learned from past mistakes. Risk oversight is the responsibility of the entire Board and the same can be achieved through a review mechanism which inter-alia could include:

1. Developing policies and procedures around risk those are consistent with the organization's strategy and risk appetite.
2. Taking steps to foster risk awareness.
3. Encourage an organizational culture of risk adjusting awareness
4. Maintenance of a Risk Register
5. A compliance certificate on the identification of risks and establishment of mitigation measures.

The updated G20/OECD Principles of Corporate Governance provides on considering the establishment of specialized board committees in areas such as remuneration, audit and risk management. The sixth principle which deals with the responsibilities of the board provides-

- The board should fulfill certain key functions, including - Reviewing and guiding corporate strategy, major plans of action, risk management policies and procedures, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.
- Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.

The Board should demonstrate a leadership role to ensure that an effective means of risk oversight is in place. Ensuring the integrity of the essential reporting and monitoring systems will require the board to set and enforce clear lines of responsibility and accountability throughout the organisation. The board will also need to ensure that there is appropriate oversight by senior management. Normally, this includes the establishment of an internal audit system directly reporting to the board. It is considered good practice for the internal auditors to report to an independent audit committee of the board or an equivalent body which is also responsible for managing the relationship with the external auditor, thereby allowing a co-ordinated response by the board. It should also be regarded as good practice for this committee, or equivalent body, to review and report to the board the most critical accounting policies which are the basis for financial reports. However, the board should retain final responsibility for oversight of the company’s risk management system and for ensuring the integrity of the reporting systems. Some jurisdictions have provided for the chair of the board to report on the internal control process. Companies with large or complex risks (financial and non-financial), not only in the financial sector, should consider introducing similar reporting systems, including direct reporting to the board, with regard to risk management.
The ICGN Global Governance Principles which describe the responsibilities of boards and shareholders respectively and aim to enhance dialogue between the two parties also provides that it is the responsibility of the board to oversee the implementation of effective risk management and proactively review the risk management approach and policies annually or with any significant business change. It provides that one of the major roles of the board is risk oversight.

**Principles on Risk oversight provides for**-

*Proactive oversight*: The board should proactively oversee, review and approve the approach to risk management regularly or with any significant business change and satisfy itself that the approach is functioning effectively. Strategy and risk are inseparable and should permeate all board discussions and, as such, the board should consider range of plausible outcomes that could result from its decision-making and actions needed to manage those outcomes.

- **Comprehensive approach**: The board should adopt a comprehensive approach to the oversight of risk which includes all material aspects of risk including financial, strategic, operational, environmental, and social risks (including political and legal ramifications of such risks), as well as any reputational consequences.

- **Risk culture**: The board should lead by example and foster an effective risk culture that encourages openness and constructive challenge of judgment's and assumptions. The company's culture with regard to risk and the process by which issues are escalated and de-escalated within the company should be evaluated at intervals as appropriate to the situation.

- **Dynamic process**: The board should ensure that risk is appropriately reflected in the company’s strategy and capital allocation. Risk should be managed accordingly in a rational, appropriately independent, dynamic and forward-looking way. This process of managing risks should be continual and include consideration of a range of plausible impacts.

- **Risk committee**: While ultimate responsibility for a company’s risk management approach rests with the full board, having a risk committee (be it a stand-alone risk committee, a combined risk committee with nomination and governance, strategy, audit or other) can be an effective mechanism to bring the transparency, focus and independent judgment needed to oversee the company’s risk management approach.

**STANDARD ON IMPLEMENTATION OF RISK MANAGEMENT**

ISO 31000:2009: International Organization for Standardization (ISO)) is a worldwide federation of national standards bodies (ISO member bodies). The work of preparing International Standards is normally carried out through ISO technical committees. Each member body interested in a subject for which a technical committee has been established has the right to be represented on that committee. International organizations, governmental and non-governmental, in liaison with ISO, also take part in the work. The main task of technical committees is to prepare International Standards.

Every activity of an organization involves risk. Organizations manage risk by identifying it, analysing it and then evaluating whether the risk should be modified by risk treatment in order to satisfy their risk criteria. Throughout this process, they communicate and consult with stakeholders and monitor and review the risk and the controls that are modifying the risk in order to ensure that no further risk treatment is required. This International Standard describes this systematic and logical process in detail. Risk management can be applied to an entire organization, at its many areas and levels, at any time, as well as to specific functions, projects and activities.
ISO 31000 published on the 13th of November 2009, provides a standard on the implementation of risk management. ISO 31000 seeks to provide a universally recognised paradigm for practitioners and companies employing risk management processes. Accordingly, the general scope of ISO 31000 - is not developed for a particular industry group, management system or subject matter field in mind, rather it provides best practice structure and guidance to all operations concerned with risk management. The scope of this approach to risk management is to enable all strategic, management and operational tasks of an organization throughout projects, functions, and processes be aligned to a common set of risk management objectives.

ISO 31000 contains 11 key principles that position risk management as a fundamental process in the success of the organization.

ISO 31000 is designed to help organizations:

- Increase the likelihood of achieving objectives
- Encourage proactive management
- Be aware of the need to identify and treat risk throughout the organization
- Improve the identification of opportunities and threats
- Comply with relevant legal and regulatory requirements and international norms
- Improve financial reporting
- Improve governance
- Improve stakeholder confidence and trust
- Establish a reliable basis for decision making and planning
- Improve controls
- Effectively allocate and use resources for risk treatment
- Improve operational effectiveness and efficiency
- Enhance health and safety performance, as well as environmental protection
- Improve loss prevention and incident management
- Minimize losses
- Improve organizational learning
- Improve organizational resilience.

ISO 31000 provides that risk oversight is a key duty of the board, as failure to manage risk can threaten the existence of the entity being governed. Countries are exploring how to improve the overall risk management framework including examining the responsibilities of different board committees.

**FRAUDS RISK MANAGEMENT**

Fraud is a deliberate action to deceive another person with the intention of gaining some things. Fraud can loosely be defined as “any behavior by which one person intends to gain a dishonest advantage over
another”. In other words, fraud is an act or omission which is intended to cause wrongful gain to one person and wrongful loss to the other, either by way of concealment of facts or otherwise.

Section 25 of the Indian Penal Code, 1860 defines the word, “Fraudulently”, which means, a person is said to do a thing fraudulently if he does that thing with intent to defraud but not otherwise.

Further according to section 17 of the Indian Contract Act, 1872, ‘fraud’ means and includes any of the following acts committed by a party to a contract, or with his connivance (intentional active or passive acquiescence), or by his agent with intent to deceive or to induce a person to enter into a contract.

1. The suggestion that a fact is true when it is not true and the persons making the suggestion does not believe it to be true;
2. The active concealment of a fact by a person having knowledge or belief of the fact;
3. A promise made without any intention of performing it;
4. Any other act fitted to deceive;
5. Any such act or omission as the law specially declares to be fraudulent.

The Companies Act 2013 has also explained fraud. Explanation to Section 447 defines “fraud”, which reads as under:

“fraud” in relation to affairs of a company or anybody corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.

A definition of fraud has been suggested in the context of electronic banking in the Report of RBI Working Group on Information Security, Electronic Banking, Technology Risk Management and Cyber Frauds, which reads as under: “A deliberate act of omission or commission by any person, carried out in the course of a banking transaction or in the books of accounts maintained manually or under computer system in banks, resulting into wrongful gain to any person for a temporary period or otherwise, with or without any monetary loss to the bank”.

For prevention of the fraud, there should be in existence a robust internal check and control systems. For example in banking there is a concept of ‘maker’ and ‘checker’. The day today transactions are entered by the maker and another person validates the transactions. So it is a self balancing system. Further the internal/concurrent audit also helps in early detection of the frauds.

The management should be pro-active in fraud related matter. A fraud is usually not detected until and unless it is unearthed. Fraud Risk Management Policy be incorporated, aligned to its internal control and risk management. Such policy/plan protects the company from any kind of uncertain happening which leads the company to a huge loss or damage (brand reputation, financial loss, assets).

The Fraud Risk Management Policy will help to strengthen the existing anti-fraud controls by raising the awareness across the Company and (i) Promote an open and transparent communication culture (ii) Promote zero tolerance to fraud/misconduct (iii) Encourage employees to report suspicious cases of fraud/misconduct. (iv) Spread awareness amongst employees and educate them on risks faced by the company.

Such a policy may include the following:
• **Defining fraud:** This shall cover activities which the company would consider as fraudulent.

• **Defining Role & responsibilities:** The policy may define the responsibilities of the officers who shall be involved in effective prevention, detection, monitoring & investigation of fraud. The company may also consider constituting a committee or operational structure that shall ensure an effective implementation of anti-fraud strategy of the company. This shall ensure effective investigation in fraud cases and prompt as well as accurate reporting of fraud cases to appropriate regulatory and law enforcement authorities.

• **Communication channel:** Encourage employees to report suspicious cases of fraud/misconduct. Any person with knowledge of suspected or confirmed incident of fraud/misconduct must report the case immediately through effective and efficient communication channel or mechanism.

• **Disciplinary action:** After due investigations disciplinary action against the fraudster may be considered as per the company’s policy.

• **Reviewing the policy:** The employees should educate their team members on the importance of complying with Company’s policies & procedures and identifying/ reporting of suspicious activity, where a situation arises. Based on the developments, the policy should be reviewed on periodical basis.

### Reporting of fraud under Companies Act 2013

The Companies Act, 2013 has introduced many new reporting requirements for the statutory auditors of companies. One of these requirements is given under the Section 143(12) of the Companies Act, 2013 which requires the statutory auditors or cost accountant or company secretary in practice to report to the Central Government about the fraud/suspected fraud committed against the company by the officers or employees of the company.

Sub-section 12 of Section 143 of the Companies Act, 2013 reads as under:

“Notwithstanding anything contained in this section, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed:

Provided that in case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed:

Provided further that the companies, whose auditors have reported frauds under this sub-section to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board’s report in such manner as may be prescribed.”

Sub-section 14 of Section 143 further provides that the provisions of this section shall mutatis mutandis apply to—

(a) the cost accountant conducting cost audit under section 148; or

(b) the company secretary in practice conducting secretarial audit under section 204.

Consequence of non-compliance: Sub-section 15 of section 143 states that if any auditor, cost accountant or company secretary in practice do not comply with the provisions of sub-section (12), he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.
Section 143(12) includes only fraud by officers or employees of the company and does not include fraud by third parties such as vendors and customers.

### Secretarial Audit

Secretarial Audit is a process to check compliance with the provisions of all applicable laws and rules/regulations/procedures; **adherence to good governance practices** with regard to the systems and processes of seeking and obtaining approvals of the Board and/or shareholders, as may be necessary, for the business and activities of the company, carrying out activities in a lawful manner and the maintenance of minutes and records relating to such approvals or decisions and implementation.

Section 204 of Companies Act 2013 provides for Secretarial audit for bigger companies.

1. Every listed company and a company belonging to other class of companies as may be prescribed shall annex with its Board’s report made in terms of sub-section (3) of section 134, a secretarial audit report, given by a company secretary in practice, in such form as may be prescribed. Rule 9 of Companies (Appointment and Remuneration of Managing Personnel) Rules, 2014 provides that for the purposes of sub-section (1) of section 204, the other class of companies shall be as under:
   - every public company having a paid-up share capital of fifty crore rupees or more; or
   - every public company having a turnover of two hundred fifty crore rupees or more.

2. It shall be the duty of the company to give all assistance and facilities to the company secretary in practice, for auditing the secretarial and related records of the company.

3. The Board of Directors, in their report made in terms of sub-section (3) of section 134, shall explain in full any qualification or observation or other remarks made by the company secretary in practice in his report under sub-section (1).

4. If a company or any officer of the company or the company secretary in practice, contravenes the provisions of this section, the company, every officer of the company or the company secretary in practice, who is in default, shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

### REPUTATION RISK MANAGEMENT

The Reserve Bank of India in its Master Circular number RBI/2015-16/85 DBR.No.BP.BC.4./21.06.001/2015-16 July 1, 2015 has defined the Reputation Risk as the risk arising from negative perception on the part of customers, counterparties, shareholders, investors, debt-holders, market analysts, other relevant parties or regulators that can adversely affect a bank’s ability to maintain existing, or establish new, business relationships and continued access to sources of funding (eg through the interbank or securitization markets). Reputational risk is multidimensional and reflects the perception of other market participants. Furthermore, it exists throughout the organisation and exposure to reputational risk is essentially a function of the adequacy of the bank’s internal risk management processes, as well as the manner and efficiency with which management responds to external influences on bank-related transactions.

Loss of Reputation has long lasting damages:

- It destroys the Brand Value
- Steep downtrend in share value.
- Ruined of Strategic Relationship
▪ Regulatory relationship is damaged which leads to stringent norms.
▪ Recruitment to fetch qualified staff as well the retention of the old employees becomes difficult.

For managing the reputation risk, the following principles are worth noting:
▪ Integration of risk while formulating business strategy.
▪ Effective board oversight.
▪ Image building through effective communication.
▪ Promoting compliance culture to have good governance.
▪ Persistently following up the Corporate Values.
▪ Due care, interaction and feedback from the stakeholders.
▪ Strong internal checks and controls
▪ Peer review and evaluating the company’s performance.
▪ Quality report/ newsletter publications
▪ Cultural alignments

**RESPONSIBILITY OF RISK MANAGEMENT**

Section 134(3) (n) of the Companies Act, 2013 provides that a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company.

SEBI (LODR) Regulations, 2015 also provides that company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the company.

The Risk Management Plan must include all elements of risks. The traditional elements of potential likelihood and potential consequences of an event must be combined with other factors like the timing of the risks, the correlation of the possibility of an event occurring with others, and the confidence in risk estimates.

Risk management policies should reflect the company’s risk profile and should clearly describe all elements of the risk management and internal control system and any internal audit function. A company’s risk management policies should clearly describe the roles and accountabilities of the board, audit committee, or other appropriate board committee, management and any internal audit function.

A company should have identified Chief Risk Officer manned by an individual with the vision and the diplomatic skills to forge a new approach. He may be supported by “risk groups” to oversee the initial assessment work and to continue the work till it is completed.

An integrated approach to risk management deals with various risks as they affect organizational objectives and limitations. The aim must be to develop a culture of risk awareness and understanding. This helps better decision making in day-to-day work by all employees.

1. Risk Management Committee:

Regulation 21 of SEBI (LODR) Regulations, 2015, requires that every listed company should have a Risk Management Committee. It reads as under:
(1) The board of directors shall constitute a Risk Management Committee.

(2) The majority of members of Risk Management Committee shall consist of members of the board of directors.

(3) The Chairperson of the Risk management committee shall be a member of the board of directors and senior executives of the listed entity may be members of the committee.

3[(3A) The risk management committee shall meet at least once in a year. ]

(4) The board of directors shall define the role and responsibility of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit 4[such function shall specifically cover cyber security].

(5) The provisions of this regulation shall be applicable to top 5[500] listed entities, determined on the basis of market capitalisation, as at the end of the immediate previous financial year.

The terms of reference of the Risk Management Committee inter-alia may include the following:

- Framing of Risk Management and Policy
- Overseeing implementation of Risk Management and Policy
- Monitoring of Risk Management and Policy
- Validating the process of Risk Management
- Validating the procedure for Risk Mitigation
- Periodically reviewing and evaluating the Risk Management Policy and practices with respect to risk assessment and risk management processes.
- Continually obtaining reasonable assurance from management that all known and emerging risks have been identified and mitigated or managed.
- Performing such other functions as may be necessary or appropriate for the performance of its oversight function.

Role of Company Secretary in Risk Management

The company secretaries are governance professionals whose role is to enforce a compliance framework to safeguard the integrity of the organization and to promote high standards of ethical behavior. He has a significant role in assisting the board of the organization to achieve its vision and strategy. The activities of the governance professional encompass legal and regulatory duties and obligations and additional responsibilities assigned by the employer. However, in essence, the functions of a Governance Professional include:

- Advising on best practice in governance, risk management and compliance.
- Championing the compliance framework to safeguard organizational integrity.

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3 Inserted by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. 1-4-2019.
4 Inserted by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. 1-4-2019.
5 Substituted for "100" the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. 1-4-2019.
- Promoting and acting as a 'sounding board' on standards of ethical and corporate behavior.
- Balancing the interests of the Board or governing body, management and other stakeholders.

Section 205 (1) of the Companies Act, 2013 deals with the functions of the company secretary. It provides that the functions of the company secretary shall include,—

(a) to report to the Board about compliance with the provisions of this Act, the rules made thereunder and other laws applicable to the company;
(b) to ensure that the company complies with the applicable secretarial standards;
(c) to discharge such other duties as may be prescribed.

Explanation.—For the purpose of this section, the expression "secretarial standards" means secretarial standards issued by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980 (56 of 1980) and approved by the Central Government.

Rule 10 of the Companies (Appointment & Remuneration of Managerial Personnel) Rules 2014 specifies that the duties of Company Secretary shall also discharge, the following duties, namely:-

(1) to provide to the directors of the company, collectively and individually, such guidance as they may require, with regard to their duties, responsibilities and powers;
(2) to facilitate the convening of meetings and attend Board, committee and general meetings and maintain the minutes of these meetings;
(3) to obtain approvals from the Board, general meeting, the government and such other authorities as required under the provisions of the Act;
(4) to represent before various regulators, and other authorities under the Act in connection with discharge of various duties under the Act;
(5) to assist the Board in the conduct of the affairs of the company;
(6) to assist and advise the Board in ensuring good corporate governance and in complying with the corporate governance requirements and best practices; and
(7) to discharge such other duties as have been specified under the Act or rules; and
(8) such other duties as may be assigned by the Board from time to time.

The listing agreement also provides for the establishment of the Risk Management Committee as per Regulations. Since it is the part of the Corporate Governance norms and non-compliance of the same is to be reported by the Company Secretary.

In terms of Section 203(1)(ii), a Company Secretary is a Key Managerial Person. Hence being a top level officer and board confidante, a Company Secretary can play a role in ensuring that a sound Enterprise wide Risk Management [ERM] which is effective throughout the company is in place. The board of directors may have a risk management sub-committee assisted by a Risk Management Officer. As an advisor to the board in ensuring good governance, a Company Secretary shall ensure that there is an Integrated Framework on which a strong system of internal control is built. Such a Framework will become a model for discussing and evaluating risk management efforts in the organization. Risk and control consciousness should spread throughout the organization. A Company Secretary can ensure that this happens so that the risk factor will come into consideration at the every stage of formulation of a strategy. It will also create awareness about inter-relationships of risks across business units and at every level of the organization. A Company Secretary
can ensure that the following questions [an illustrative list] are effectively addressed at the board level:

- What is the organization’s risk management philosophy?
- Is that philosophy clearly understood by all personnel?
- What are the relationships among ERM, performance, and value?
- How is ERM integrated within organizational initiatives?
- What is the desired risk culture of the organization and at what point has its risk appetite been set?
- What strategic objectives have been set for the organization and what strategies have been or will be implemented to achieve those objectives?
- What related operational objectives have been set to add and preserve value?
- What internal and external factors and events might positively or negatively impact the organization’s ability to implement its strategies and achieve its objectives?
- What is the organization’s level of risk tolerance?
- Is the chosen risk response appropriate for and in line with the risk tolerance level?
- Are appropriate control activities (i.e., approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets, segregation of duties) in place at every level throughout the organization?
- Is communication effective — from the top down, across, and from the bottom up the organization?
- How effective is the process currently in place for exchanging information with external parties?
- What is the process for assessing the presence and performance quality of all eight ERM components over time?

**RISK GOVERNANCE**

There is an enhanced realisation that the risk governance demands a holistic approach and that risk appreciation should start at the top. A strengthened management information system (MIS) supported by robust information technology platform is a necessary pre-requisite for enhancing Board efficiency in oversight and decision making. Similarly, augmented skill sets and experience at the level of independent directors would go a long way in enhancing the Board capacity. Strong MIS facilitates risk reporting to the boards in an effective and comprehensive manner, which in turn enhances transparency and causes informed decision taking. Robust information technology systems are a necessary condition for supporting the MIS framework as the quality of risk information that the Boards and the top management receive depends largely on the quality and robustness of the information technology systems.

In addition to prescribing the risk appetite for the company, the board also needs to lay down appropriate risk strategy and ensure that this is institutionalised throughout the organization. This would entail, aligning risk management processes with the overall business strategy, clearly defining the roles and responsibilities down the hierarchy, establishing accountability and reinforcing change with communication and training. The Board and the senior management oversight must be supplemented with effective leadership by the Chairman and the chief executive officer (CEO), and informed non-executive directors. The Boards must get much more intimately involved in risk matters and have a firmer understanding of the key risks faced by the business.

Effective risk governance also demands that each director is aware of the breadth of risks faced by the
company. Directors add value to the Board when they have financial expertise, are aware of risk fundamentals and techniques, and are able to manage dynamics with executives.

Here, the risk management committees have an important role to play in the overall risk governance framework. Apart from monitoring the company’s strategic-risk profile on an on-going basis, such committees would also be responsible for defining the company’s overall risk appetite; approving major transactions above a company’s risk threshold; and; establishing limit structures and risk policies for use within individual businesses.

Presence of a Chief Risk Officer (CRO) is expected to strengthen the risk management framework. However, independence of the CRO, with necessary stature to influence decisions, would be a critical element in ensuring the effectiveness of the post in risk management process as also the strategic risk management related decisions. The CRO must report directly to the CEO and the Board and be responsible for all risks, risk management and control functions. Another important requirement is integrating risk with business strategy and compensation. Risk – and return on risk – need to be core component of any performance measure, and should be explicitly factored into incentive and compensation schemes. Compensation must be formally aligned with actual performance, such as through adding more rigorous risk-based measures to scorecards. This would also involve moving to longer vesting periods, and increasing deferred compensation.

The fragmented organisation of risk data into separate silos slows down risk management process and hinders the capability to respond to new regulatory requirements. The financial crisis has pushed both supervisors and market players to move towards an integrated approach to risk data that brings down the silos in organisation. Only by integrating data models, processes and methodologies can a bank achieve higher performance in terms of data quality.

The risk management systems must take into account the technical limitations of risk models, such as Value at Risk (VaR). Stress testing and scenario analysis need to be established as truly effective management tools and should be integrated and standardized across business lines, types of risk and asset classes.

<table>
<thead>
<tr>
<th>Sl.No</th>
<th>Risk Area</th>
<th>Key risks</th>
<th>Root cause</th>
<th>Mitigation measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Business Risk</td>
<td>Decreasing market share</td>
<td>Lack of innovation, market survey etc.,</td>
<td>Keeping a vigil on latest developments and continuous monitoring</td>
</tr>
<tr>
<td>2.</td>
<td>Financial risk</td>
<td>Leveraging capital structure and the cash flows</td>
<td>Inability to assess the appropriate funding requirements</td>
<td>Adopting a Resource planning policy</td>
</tr>
<tr>
<td>3.</td>
<td>Regulatory &amp; Compliance Risk</td>
<td>Non-compliance of applicable laws</td>
<td>Not keeping abreast of the latest changes in the Regulatory environment</td>
<td>Knowledge updation &amp; maintenance of a robust compliance check list</td>
</tr>
</tbody>
</table>
Risk Matrix

Risk Matrix is a matrix that is used during Risk & Control Self Assessment (RCSA) activity to define the various levels of risk at each stage, activity, process and sub process.

Risk Matrix comprises of:

1) Impact analysis
2) Likelihood
3) Operating Effectiveness
4) Design Effectiveness

Ratings are assigned to all above categories, pre and post control environment. Based on the ratings a Gross/Inherent Risk Level and Residual Risk level is determined (HIGH/MEDIUM/LOW), respectively.

In the event where Residual Risk level is HIGH and/or a particular control environment is weak, these are mitigated with additional controls.

The Inherent and Residual Risks follow the RED-AMBER-GREEN color coding mapped to HIGH-MEDIUM-LOW Risks, respectively.

Model risk management policy

A risk management policy serves two main purposes: to identify, reduce and prevent undesirable incidents or outcomes and to review past incidents and implement changes to prevent or reduce future incidents. A risk management policy should include the following sections:

- Risk management and internal control objectives (governance)
- Statement of the attitude of the organisation to risk (risk strategy)
- Description of the risk aware culture or control environment
- Level and nature of risk that is acceptable (risk appetite)
- Risk management organisation and arrangements (risk architecture)
- Details of procedures for risk recognition and ranking (risk assessment)
- List of documentation for analysing and reporting risk (risk protocols)
- Risk mitigation requirements and control mechanisms (risk response)
- Allocation of risk management roles and responsibilities
- Risk management training topics and priorities
- Criteria for monitoring and benchmarking of risks
- Allocation of appropriate resources to risk management
- Risk activities and risk priorities for the coming year
### GLOSSARY OF TECHNICAL WORDS

- **Risk Management**: Risk management is the identification, evaluation, and prioritization of risks followed by coordinated and economical application of resources to minimize, monitor, and control the probability or impact of unfortunate events or to maximize the realization of opportunities.

- **SWOT**: SWOT analysis is a framework used to evaluate a company's competitive position by identifying its strengths, weaknesses, opportunities and threats. Specifically, SWOT analysis is a foundational assessment model that measures what an organization can and cannot do, and its potential opportunities and threats.

- **Fraud Risk**: A fraud risk assessment is a tool used by management to identify and understand risks to its business and weaknesses in controls that present a fraud risk to the organization.

- **Secretarial Audit**: Secretarial Audit is an audit to check compliance of various legislations including the Companies Act and other corporate and economic laws applicable to the company. It provides necessary comfort to the management, regulators and the stakeholders, as to the statutory compliance, good governance and the existence of proper and adequate systems and processes.

### LESSON ROUND UP

- Risk is inherent in the business. Different types of risk exist in the business according to the nature of the business and they are to be controlled and managed.

- In traditional concept the natural calamities like fire, earthquake, flood, etc were only treated as risk and keeping the safe guard equipments etc were assumed to have mitigated the risk. But due to rapid changes, the various types of risks have emerged viz. Compliance risk, legal risk, country risk, operational risk.

- Risk may be controllable or uncontrollable. In other words, the systematic risk which stands at macro level is not controllable, but the unsystematic risk which is at micro level is controllable with the risk mitigation techniques.

- The risk may broadly be segregate as Financial Risk and Non-financial Risk.

- Financial Risk includes market risk, credit risk Liquidity risk, Operational Risk, Legal Risk and Country Risk. Non-financial risk does not have immediate financial impact on the business, but its consequence is serious.

- Non-Financial Risk do not have immediate financial impact on the business, but its consequence are very serious and later may have the financial impact. This type of risk may include, Business/Industry & Service Risk, Strategic Risk, Compliance Risk, Fraud Risk, Reputation Risk, Transaction risk, Disaster Risk.

- To mitigate the various types of risks, which a business entity faces, a proper risk management process should be in force. It is a continuous process and is applied across the organisation. It is basically the identification of risk areas, assessment thereof, evaluating the impact of such risk, develop the risk mitigation techniques, establishing the sound internal control process and continuous monitoring thereof, setting of standards for each process and abnormal variances to be vetted.

- Risk management plays vital role in strategic planning. It is an integral part of project management. An effective risk management focuses on identifying and assessing possible risks.

- The process of risk management consists of the following logical and sequential steps, Identification of risk, Assessment of risk, Analysing and evaluating the risk, Handling of risk (Risk may be handled through the Risk Avoidance, Risk Retention/ absorption, Risk Reduction, Risk Transfer) and Implementation of risk management decision.
• ISO 31000 published as a standard on the 13th of November 2009, provides a standard on the implementation of risk management. ISO 31000 contains 11 key principles that position risk management as a fundamental process in the success of the organization.

• Fraud has been defined as, ‘A deliberate act of omission or commission by any person, carried out in the course of a banking transaction or in the books of accounts maintained manually or under computer system in banks, resulting into wrongful gain to any person for a temporary period or otherwise, with or without any monetary loss to the bank’.

• Reputation Risk as the risk arising from negative perception on the part of customers, counterparties, shareholders, investors, debt-holders, market analysts, other relevant parties or regulators that can adversely affect a bank’s ability to maintain existing, or establish new, business relationships and continued access to sources of funding (e.g. through the interbank or securitisation markets).

• SEBI (LODR) Regulations, requires that every listed company should have a Risk Management Committee.

• Secretarial Audit is a process to check compliance with the provisions of all applicable laws and rules/regulations/procedures; adherence to good governance practices with regard to the systems and processes of seeking and obtaining approvals of the Board and/or shareholders, as may be necessary, for the business and activities of the company, carrying out activities in a lawful manner and the maintenance of minutes and records relating to such approvals or decisions and implementation.

• Secretarial Audit helps the companies to build their corporate image. Secretarial Audit facilitates monitoring compliances with the requirements of law through a formal compliance management programme which can produce positive results to the stakeholders of a company.

SELF TEST QUESTIONS

1. What do you mean by Risk Management?
2. Discuss about the Controllable and Un-controllable Risks.
3. Elaborate on different types of Financial and Non-financial Risk.
4. Describe the Risk Management Process and its advantages?
5. What do you understand by Fraud risk? What strategy can adopt to mitigate such a risk?
6. Write short notes on:
   b. Fraud Risk Management.
   c. Reputation Risk Management.
   d. Secretarial Audit and Role of Company Secretary.
   e. Reporting of fraud by Statutory Auditor.
Lesson 12
Compliance Management

LESSON OUTLINE

- Introduction
- Significance of compliance
- Essentials of an effective compliance program
- Compliance Management process and Reporting
- Scope of Corporate Compliance Management
- Use of technology for compliance management
- Compliance solutions
- Compliance with Spirit of Law
- Role of Company Secretary
- Conclusions
- Glossary
- Lesson Round-UP
- Self Test Questions

LEARNING OBJECTIVES

The objective of this study lesson is to enable the students to understand the importance of compliance management in order to inculcate the compliance culture in the corporate.

This contains the adequacy and effectiveness of the compliance system, internal compliance reporting mechanism and ensuring the best practices available for the good governance principles for compliance issues.

This chapter may be useful in performing the advisory role and in compliance management in practical areas of work.

“It takes 20 years to build a reputation and five minutes to ruin it. If you think about that, you’ll do things differently.”

Warren Buffett
INTRODUCTION

As an emerging market, India is one of the fastest growing economies in the world today. India is cited as having the potential to become the third largest economy in the world within the next 30 years, behind only China and the USA. Over the past several years, the policy and procedures regulating and governing the Indian corporations have been progressively liberalized and simplified.

However, there are several compliance requirements that need to be adhered to, failing which there could be consequences of disqualification of directors, attracting of penal provisions and in some cases even imprisonment of the directors and key personnel. Such a flood of regulation is not unusual for India. It is the path taken by several economies as they transitioned from low income countries to advanced economies at the frontiers of development.

Simply put, compliance means the complete alliance of various parts of the business – whether commercial, financial, or regulatory. It necessitates following the rules, both external and internal. External compliance is about the regulatory aspects, which are enforced by the law to ensure that the business is adhering to legal parameters defined by the state. Internal compliance concerns the standards and policies designed by the firm to deliver a product or service.

According to research top three board priorities indicated are:

- Ensuring overall corporate and statutory compliance (90%),
- Monitoring business and operating performance (87%),
- Establishing and monitoring financial standards and internal controls (82%).
- Leadership development, succession planning, CSR and risk management continue to be low on the board priority list.

Perhaps not surprisingly, meeting compliances has emerged as the top Board priority.

A compliance management system is the method by which corporate manage the entire compliance process. It includes the compliance program, compliance audit, compliance report etc. and in other words it is called compliance solution.

The compliance program consists of the policies and procedures which guide in adherence of laws and regulations. The compliance audit is independent testing of level of compliance with various laws and regulations applicable.

Compliance with law and regulation must be managed as an integral part of any corporate strategy. The board of directors and management must recognize the scope and implications of laws and regulations that apply to the company. They must establish a compliance management system as a supporting system of risk management system as it reduces compliance risk to a great extent. To ensure an effective approach to compliance, the participation of senior management in the development and maintenance of a compliance program is necessary. They should review the effectiveness of its compliance management system at periodic intervals, so as to ensure that it remains updated and relevant in terms of modifications/ changes in regulatory regime including acts, rules, regulations etc. and business environment.

Corporate compliance management involves a full process of research and analysis as well as investigation and evaluation. Such an exercise is undertaken in order to determine the potential issues and get a realistic view about how the entity is performing and how it is likely to perform in the future. Company Secretaries
with core competence in compliance and corporate governance play a crucial role in the corporate compliance management.

**SIGNIFICANCE OF COMPLIANCE**

Corporate accountability is on everyone’s mind today. Business executive faces significant pressure to comply with a steady stream of complex regulations. Many companies are adopting comprehensive compliance plans to address emerging regulatory paradigm and those that fail to address the new regulations risk losing business, paying hefty fines or incurring punitive restrictions on their operations.

As the organizations face mounting pressures that are driving them towards a structured approach to enterprise-wise compliance management, the key drivers of compliance management encompass, the complexity of today’s business, dependency on IT and hi-tech processes, growth in business partner relationships. Increased liability and regulatory oversight has amplified risk to a point where it demands continuous evaluation of compliance management systems. Furthermore, the multiplication of compliance requirements that organizations face increases the risk of non-compliance, which may have potential civil and criminal penalties. The following may add to the significance of the corporate compliance management:

- Image building of a responsible corporate citizen
- Stake holders can trust in the working of the corporate
- Prevent improper conduct in the organization
- It keeps things running smoothly and minimizes risks
- It helps the company in maintaining a good reputation
- Real time status of legal/statutory compliances
- Prevent unintended non compliances/ prosecutions
- Higher Productivity in the Company
- Building Positive Reputation
- It enhances credibility/creditworthiness being a law abiding company
- Proper compliance management avoids the penal provisions
- Saves cost in litigation by avoiding penalties/fines
- It lays down the foundation for the control environment.
- Enjoys healthy returns through employee and customer loyalty
- Benefits of compliance program far outweigh its costs

The focused attention on compliances with spirit and details of laws casts upon Company Secretaries an onerous responsibility to guide the corporates adapting with compliance regimes, so as to ensure extended protection to investors, shareholders and other stakeholders. They have to advise companies in totality to provide full, timely and intelligible information. To enable companies to put in place an effective Compliance Management System, company secretaries should ensure that companies:

- adhere to necessary industry and government regulations,
- Change business processes according to legislative change,
— Realign resources to meet compliance deadlines,
— React quickly and cost-effectively if regulations change.

The risks of non-compliance of the law are many:

1. Cessation of business activities
2. Civil action by the authorities
3. Punitive action resulting in fines against the company/officials
4. Imprisonment of the errant officials
5. Public embarrassment
6. Damage to the reputation of the company and its employees
7. Plummetsing stock price and threat of de-listing of shares (in case of listed companies)
8. Attachment of bank accounts.

Compliance with the requirements of law through a compliance management programme can produce positive results at several levels:

— Companies that go the extra mile with their compliance programs lay the foundation for the control environment.
— Companies with effective compliance management programme are more likely to avoid stiff personal penalties, both monetary and imprisonment.
— Companies that embed positive ethics and effective compliance management programme deep within their culture often enjoy healthy returns through employee and customer loyalty and public respect for their brand, both of which can translate into stronger market capitalization and shareholder returns.

Clearly, the benefits of implementing and maintaining an effective ethics and compliance program far outweigh its costs. Not only does the compliance management protect investors wealth but also helps the business in running successfully with any potential risk being addressed in a timely and accurate manner.

Since 1991, in USA, the companies that create, communicate, enforce, and promote effective compliance programs, as defined by the U.S. Federal Sentencing Guidelines for Organizations, have been given favorable treatment by the Department of Justice, even when misconduct by employees in their organizations has been proven. The resultant savings, in terms of mitigated fines, has totalled hundreds of millions of dollars.

**ESSENTIALS OF AN EFFECTIVE COMPLIANCE PROGRAM**

A corporate compliance program is generally defined as a formal program specifying an organization's policies, procedures, and actions within a process to help prevent and detect violations of laws and regulations. The essential of a successful compliance program may be list out as under:

1. **Development of written Compliance Policies, Procedures and framing of Standards:** The successful implementation of any compliance program needs a well drafted written document of the compliance policy. Until and unless one have a written policy, how the deviation from the set standard will be measured. Hence it is of utmost necessary that there shall be a compliance policy
in existence duly approved by the Board of Directors. The policy shall contain the regulatory aspects which in force as on the date of the framing of the policy, based on the such rules and regulations in force, set a Code of Conduct / Standards, action to be taken in case of deviations from the set standards and also the initiation of the disciplinary actions against the erring staff. Further it is also important that the compliance policies and procedures should be designed in such a way that it helps employees remain in compliance while carrying out their job functions.

2. **Designation of a compliance officer and compliance committee:** The Compliance Policy shall contain a clause of appointment of a designated compliance officer, who shall take care of the regulatory compliance related functions and he shall be responsible to ensure to have the adherence of the compliance policy and put up a note before the Board of Directors periodically for their perusal and directions wherever required. The Board approved note, where ever required be submitted to Regulatory Authorities.

3. **Developing open lines of communication:** The Compliance Policy shall have a provision to welcome open communication as a product of organizational culture and internal mechanisms for reporting instances of potential fraud and abuse. This concept of whistle blower, may prove to be early warning signals and may be effective in prevention thereof. The name and designation of the reporting official shall be kept confidential.

4. **Appropriate training and education:** For effective implementation and inculcation of the compliance policy, there is need of proper training and education to the field functionaries and policy implementing officials.

5. **Internal monitoring and auditing:** The compliance policy shall contain a clause for having the effective auditing and monitoring plans.

6. **Response to detected deficiencies:** Wherever the deficiencies in the prescribed procedure come in the knowledge of the concerned official, there shall be a reporting system to make a report to the designated official.

7. **Enforcement of disciplinary standards:** There shall be a clause in the compliance policy to take the disciplinary action against the erring official, who have not adhered the prescribes set of rules and regulations.

8. **Effective use of Information technology:** By using available tools of information technology compliances can be managed effectively. There are various compliance management software available now which facilitate compliance management.

**PROCESS OF CORPORATE COMPLIANCE MANAGEMENT AND REPORTING**

Installing proper compliance process is a must for the success of compliance programme. Systematic approach helps in chalking out a plan of action in right direction. Installing a process presupposes planning for the activity, identification of desired objective and resources, detailed plan of action with provision for eventualities and continuous monitoring and corrective measures.

Some companies have a streamlined, highly efficient system for managing their compliance requirements. By adopting a unified approach to regulatory management, companies can minimize costs, maximize efficiency and reduce their risk exposure. Such firms, though, are in the minority. More often, there is considerable duplication of cost and effort as organizations attempt to deal with the requirements of multiple regulatory bodies across their operations.

It is desirable that the compliance management process is so designed that it is able to generate a complete
MIS Report for secretarial and legal data providing the key information including company details, key dates, brief information about company’s business, certifications obtained, addresses of office locations, details of Board of Directors, shareholding pattern, key registration nos. such as company registration no., scrip code, ISIN code etc., contact details of agencies such as auditors, consultant, banker, government agencies, printers, R&T agents etc. Purely for a legal function database of immovable properties, on-going litigations, compliance reports, list of power of attorneys issued etc. prove immensely useful and provide timely information, to take necessary action to correct non-compliance, if any.

It is essential to segregate roles and responsibilities within the function to ensure proper distribution of work, rotation of responsibilities where possible, avoid confusion and set focus for each person within the function.

Considering the multiplicity of laws that are applicable to companies in India, a systematic approach to corporate compliance management is worth doing an exercise to go through a list of laws and identifying those relevant to the industry and business to which the company belongs and categorizing them in future to focus on critical compliances. Critical compliance means the severity of compliance and its impact on business, while it is true that all laws are of equal importance and should be complied with in letter and spirit.

Internal Compliance Reporting Mechanism (ICRM)

The Internal Compliance Reporting Mechanism (ICRM) should be sound and fool proof. Deviations in non-reporting should be avoided. In any Compliance Program it is of paramount important that the employees working in the organisation shall feel free in reporting non-compliance related issues either by their own parts or has observed any deficiency on the counter part. The ICRM may involve the following process:

- Establish a robust reporting mechanism
- Encourage employees to report the non-compliance in a fear less environment.
- Define the parameters of the compliance issues based on the legal requirements prevailing in force.
- Develop the measures to weigh the variation to the prescribed standards.
- Functional Heads be made responsible to collect such information in a time bound manner.
- Early warning signals should be identified of the possible areas of the non-compliances.

TRACE International INC (US), in its guide book titled as ‘First to Know’ has narrated some key points as components of a robust programme. It provides that:

An internal reporting mechanism need not be expensive. It must go far beyond a written policy, however, and it must be designed to reflect the practices, laws and cultures of the countries in which the company is operating. Any broken link in the reporting chain can interrupt the flow of information from the reporter to those who need to hear and act on it. A sound program should include the following elements:

- Communication: make the program known to all levels of employees.
- Accessibility: make the program available to all employees around the world in various languages.
- Cultural Appropriateness: adapt the program to the constraints imposed by local culture, history and practice.
- Universality: make the reporting mechanism available to relevant third parties, e.g. suppliers, consultants, customers.
- Confidentiality and Anonymity: guarantee confidentiality and permit discreet or anonymous reports.
• Screening: provide safeguards against frivolous or malicious reports.
• Collect Data: monitor reports, track them over time, identify vulnerabilities and take corrective action.
• Remedial Action and Feedback: take action and provide feedback to the reporter as appropriate.
• Management Visibility: report to the audit committee or board of directors.
• Employee Protection: protect reporting employees both during employment and after departure from the company.
• External Communication: report to shareholders and other interested parties on actions taken and results achieved.

**SCOPE OF CORPORATE COMPLIANCE MANAGEMENT**

Corporate compliance management should broadly include compliance of:

— Corporate Laws
— Securities Laws
— Commercial Laws including Intellectual Property Laws
— Labour Laws
— Tax Laws
— Pollution Control Laws
— Industry Specified laws
— All other Laws affecting the company concerned depending upon the type of industry/activity.

The details of the above mentioned legislations are given below.

**(a) Corporate & Economic Laws**

Corporate laws are core competence areas of a Company Secretary and corporate compliance management broadly requires complete compliance of these laws. Some of the important corporate laws are given below in brief:

— Companies Act, 1956 and the various Rules and Regulations framed there under, MCA-21 requirements and procedures.
— Secretarial Standards/Accounting Standards/Cost Accounting Standards issued by ICSI/ICAI/ICAI(Cost) respectively.
— Foreign Exchange Management Act, 1999 and the various Notifications, Rules and Regulations framed there under.
— Competition Law.
— Special Economic Zones Act, 2005.

(b) Securities Laws
— SEBI Act, 1992
— Securities (Contracts) Regulation Act, 1956 and rules made thereunder
— Various rules, regulations guidelines and circulars issued by SEBI
— Provisions of SEBI (Listing Obligations and Disclosure requirements) Regulations, 2015
— Sarbanes-Oxley Act, 2002 and other legislations etc, wherever applicable.
— Depositories Act, 1996

(c) Commercial Laws
— Indian Contract Act, 1872
— Transfer of Property Act, 1882
— Arbitration and Conciliation Act, 1996
— Negotiable Instruments Act, 1881
— Sale of Goods Act, 1930

(d) Fiscal Laws
— Income Tax Act, 1961
— Central Excise Act, 1944
— Customs Act, 1962
— Wealth Tax Act, 1957
— Central Sales Tax/State Sales Tax/VAT
— Service Tax.

(e) Labour Laws
— Minimum Wages Act, 1948
— Payment of Bonus Act, 1965
— Payment of Gratuity Act, 1972
— Employees’ Provident Funds and (Misc. Provisions) Act, 1952;
— Employees’ State Insurance Act, 1948;
— Factories Act, 1948;
— Workmen’s Compensation Act, 1923;
— Maternity Benefit Act, 1961;
— Industrial Dispute Act, 1947; and

(f) Pollution/Environment related Laws
— Air (Prevention and Control of Pollution) Act, 1981
— Water (Prevention and Control of Pollution) Act, 1974
— Water (Prevention and Control of Pollution) Cess Act, 1974
— Environment Protection Act, 1986

(g) Industry Specific Laws
Legislations applicable to specific categories of industries – electricity, power generation and transmission, insurance, banking, chit funds, etc.

(h) Local Laws
These would include Stamp Act, Registration Act, municipal and civic administration laws, shops and establishments, etc.

Individual companies may suitably add or delete to/from the above list as required.

Role of Information Technology
A critical component of an effective compliance program is the ability to monitor and audit compliance in a “real time manner.” Yet, as companies cross geographical and industry boundaries, it is becoming harder to perform this role in the traditional manner. As a result, companies are increasingly seeking technology solutions.

USE OF TECHNOLOGY FOR COMPLIANCE MANAGEMENT
Technology has become an integral part of day-today corporate compliance systems and procedures. A critical component of an effective compliance program is the ability to monitor and audit compliance in a “real time manner.” Yet, as companies cross geographical and industry boundaries, it is becoming harder to perform this role in the traditional manner. As a result, companies are increasingly seeking technology solutions.

Information Technology can play an effective role in implementation of a Corporate Compliance Management Programme across various departments of an organization in terms of real-time compliance reminders, generation of reports, sending warning signals, generation of compliance calendar etc.

Many companies are introducing a comprehensive web-based compliance system that links various offices/units for better co-ordination and continued compliance. Companies prefer to introduce full-fledged compliance management systems for smooth compliance of multiple laws. Web-based compliance software are available industry-wise and tailor made compliance software can also be made according to company specifications which has to be updated on continuous basis.

A well-designed compliance management programme has abilities to perform the following key functions across the enterprise:

• Compliance Dashboard: The compliance programme must provide a single enterprise-wide dashboard for all users to track and trend compliance events. All compliance events should be easily
viewed interactively through the enterprise compliance dashboard. External auditors, internal auditors, compliance officers can use the dashboards to make decisions on the compliance status of the organization.

- **Policy and Procedure Management:** A well-designed document management system forms the basis of managing the entire lifecycle of policies and procedures within an enterprise. Ensuring that these policies and procedures are in conformity with the ever-changing rules and regulations is a critical requirement. The creation, review, approval and release process of the policy documents and SOPs (Standard Operating Procedures) should be driven by collaborative tools that provide core document management functionality.

- **Event Management:** The compliance management system must have ability to capture and track events, cases and incidents across the extended enterprise. Compliance officers, call centre personnel, IT departments, QA personnel, ethics hotline should be able to log in any adverse event across the enterprise, upon which the necessary corrective and preventive actions are initiated.

- **Rules and Regulations:** A well-designed compliance management solution must offer capabilities for organization to continuously stay in sync with changing rules and regulations. As soon as there are regulatory changes, the various departments should be notified proactively through “email based” collaboration. This process critically enables the organization to dynamically change their policies and procedures in adherence to the rules and regulations. While tracking a single regulation may be manually feasible, it becomes an error-prone task to track all local, state, and central regulations including those taking place across the globe. A well-designed Compliance management programme offers up-to-date regulatory alerts across the enterprise.

- **Audit Management:** Audits have now become part of the enterprise core infrastructure. Internal audits, financial audits, external audits, vendor audits must be facilitated through a real-time system. Audits are no more an annual activity and corporations offer appropriate audit capabilities. Appropriate evidence of internal audits becomes critical in defending compliance to regulations.

- **Quality Management:** Most organizations have internal operational, plant-level or departmental quality initiatives to industry mandates like Six-sigma or ISO 9000. A well-designed compliance management program incorporates and supports ongoing quality initiatives. Most quality practitioners agree that compliance and quality are two sides of the same coin. Therefore, it is critical to ensure that compliance management solution offers support for enterprise-wide quality initiatives.

- **Training Management:** Most compliance programs often require evidence of employee training. Sarbanes-Oxley Act, stress on employee training. In USA, lack of documented training can lead to fines and penalties. Often the compliance office has to work closely with the HR organization to facilitate employee training. Well-designed compliance program requires a well-integrated approach to training management.

- **Compliance Task Management:** Organizations must plan, manage and report status of all compliance related activities from a centralized solution. Automated updates from the various compliance modules should provide for up-to-the-minute status reporting that could be viewed by the Board, corporate compliance officer, entity compliance coordinators, quality offices and others as designated.

**COMPLIANCE SOLUTIONS**

In this age of information technology and outsourcing, where corporate solutions are available at every step and in respect of every matter, there are several companies offering ‘compliance solutions’.
Approach to Compliance Solutions

Compliance solution providers adopt the following approaches for creating or enhancing an ethics and compliance program for companies—

Risk/Cultural Assessment: Through employee surveys, interviews, and document reviews, a company’s culture of ethics and compliance at all levels of the organization is validated. Our reports and recommendations with detail observations identify gaps between company’s current practices and benchmarks with international practices.

Program Design/Update: In this phase, compliance solution providers help the company in creating guideline documents that outline the reporting structure, communications methods, and other key components of the code of ethics and compliance program. This encompasses all aspects of the program, from grassroots policies to structuring board committees that oversee the program; from establishing the mandatory anonymous complaint reporting mechanism—i.e., compliance and ethics help line or whistleblower hot line—to spelling out the specifics of the code of ethics in a way that is easily understood by everyone at all levels of organization.

Policies and Procedures: In this phase, compliance solution providers help the company to develop or enhance the detailed policies of the program, including issues of financial reporting, antitrust, conflicts of interest, gifts and entertainment, records accuracy and retention, employment, the environment, global business, fraud, political activities, securities, and sexual harassment, among others.

Communication, Training and Implementation: Even the best policies and procedures are useless if they are not institutionalized—they must become part of the fabric of the organization. Compliance solution providers help the company to clearly articulate, communicate, and reinforce not only the specifics of the program, but also the philosophy behind it, and the day-to-day realities of it. In this way, key stakeholders and other personnel are more likely to embrace the program and incorporate it into their attitudes and behaviors.

Ongoing self-Assessment, Monitoring and Reporting: The true test of a company’s ethics and compliance program comes over time. How do one know in one year or five that both the intent and letter of the law are still being observed throughout organization? How does the program—and the organization—adapt to changing legislation and business conditions? As the organization evolves—for example, through mergers and acquisitions—will the program remain relevant? The cultural assessment, mechanisms, and processes put in place including employee surveys, internal controls, and monitoring and auditing programs, help organizations achieve sustained success.

COMPLIANCE WITH SPIRIT OF LAW (ETHICS)

The enterprise response to compliance mandates seems to be to create and implement whatever compliances are prescribed - to ‘get it done’. The goal is to simply meet the ‘letter of the law’. The effort is directed towards completing Compliance tasks as quickly as possible so all could return to ‘real’ business tasks. But ensuring compliances as per the “spirit of law” is more important.

In the context of corporate governance, compliance means obeying the law. Ethics is the intent to observe the spirit of law—in other words, it is the expressed intent to do what is right. In the wake of recent corporate scandals, a program that strongly emphasizes both ethics and compliance is good business.

The Sarbanes-Oxley Act of 2002, along with related mandates by the Securities and Exchange Commission and new listing rules instituted by the major stock exchanges including India, raise the ante for ethical behavior and effective corporate compliance programs. Public companies and their senior executives and board members may be held accountable—personally accountable in the case of the executives and board
members—not only for the financial reporting provisions of the legislations, but also for the aspects pertaining to ethics and corporate compliance. Companies and their leadership that adhere both to the letter and the spirit of the law can achieve substantial benefits.

An ethical compliance management programme ensures that the mechanisms are in place to provide early warning of deviations from guidelines and regulations. It is essential to create or expand a culture of trust, enthusiasm, and integrity - critical attributes that can produce measurable results in terms of productivity, employee satisfaction, customer satisfaction, and, ultimately, brand equity.

**ROLE OF COMPANY SECRETARIES**

Corporate Compliance Management can add substantial business value only if compliance is done with due diligence. A Company Secretary is the ‘Compliance Manager’ of the company. It is he who ensures that the company is in total compliance with all regulatory provisions. Corporate disclosures, which play a vital role in enhancing corporate valuation, is the forte of a Company Secretary. These disclosures can be classified into statutory disclosures, non-statutory disclosures, specifies disclosures and continuous disclosures. A Company Secretary has to ensure that these disclosures are made to shareholders and other stakeholders in true letter and spirit.

In nutshell, the Company Secretary is the professional who guides the Board and the company in all matters, renders advice in terms of compliance and ensures that the Board procedures are duly followed, best global practices are brought in and the organisation is taken forward towards good corporate citizenship.

**Illustration**

An illustrative study on compliance management programme with hypothetical figures, is given below for better understanding.

Compliance with the regulatory acts not only protect investors wealth but also helps the business in running successfully with any potential risk being addressed in a timely and accurate manner. A well drafted compliance management programme will function as a compliance solution that monitors the effectiveness of various controls applied to mitigate risks.

For example XYZ Ltd., a listed broking company may have compliance management programme covering the following aspects. It may be noted that this may not be a very comprehensive one.

**Compliance Management Programme for XYZ Ltd.**

**I. Background of the company**

XYZ Ltd. (herein after called ‘the company’) is a leading broking firm incorporated on 10th February, 1991, having its registered and corporate office located at Delhi and having 120 employees. The company was promoted by Mr. X, Mr. Y and Mrs. Z who are having experience in financial services sector for more than 25 years, 19 years, and 20 years respectively. The net worth of the company as on March 31, 2008 was Rs……………. crores and the market capitalization as on September 03, 2008 was Rs……………. crores.

The company is handling sizeable portion of equities and derivatives being traded on NSE and BSE. The major activities and offerings of the company today are Equity Broking and Depository Participant Services. The company is a member of the National Stock Exchange of India, Bombay Stock Exchange of India and is a Depository Participant with National Securities Depository Limited and Central Depository Services (I) Limited. The company is a listed company with BSE and NSE. The company has also issued shares under FDI scheme.
II. Identification of applicable laws

The role of information technology in identifying the applicable laws is really vital. The company can identify the applicable laws just by click of a button through software, which has to be updated from time to time. It may be possible that some of the legislations might be missed out while listing the applicable laws manually and thus Compliance management through system would help in

(i) Identifying risk attributes (i.e. identifying the applicable laws)
(ii) Application of control to mitigate the risk (control check list under various legislations (both time based and event based)
(iii) Generation of reports for identifying the non compliances
(iv) Reminder before the due date for compliance
(v) Having internal control on compliance.

In respect of the said XYZ limited, the following sample check list on applicable laws would give an idea on the same.

(It may be noted that the laws listed out here is general about drafting a compliance programme and may not be too comprehensive.)

(a) General applicability
   (i) The Companies Act, 1956
   (ii) Income Tax Act, 1961
   (iii) Contract Act, 1872
   (iv) Stamp Act
   (v) Negotiable Instruments Act, 1881

(b) Company-specific applicability (i.e. a listed broking company)
   (i) SEBI Act, 1992
   (ii) Securities Contracts (Regulation) Act, 1956
   (iii) Securities Contracts (Regulation) Rules, 1957
   (iv) Depositories Act, 1996
   (v) Prevention of Money Laundering Act, 2002
   (vi) SEBI (Intermediaries) Regulations, 2008
   (vii) SEBI (Stock Brokers and Sub-brokers) Regulations, 1992
   (viii) SEBI (Depositories and Participants) Regulations, 1996
   (ix) SEBI (Listing Obligations and Disclosure requirements) Regulations, 2015
   (x) BSE/NSE bye laws, rules and regulations

(c) Labour laws
   (i) The Employees Provident Funds and Miscellaneous Provisions Act, 1952
   (ii) The Employees State Insurance Act, 1948
(iii) The Maternity Benefit Act, 1961
(iv) The Minimum Wages Act, 1948
(v) The Payment of Bonus Act, 1965
(vi) The Payment of Gratuity Act, 1972
(vii) The Child Labour (Prohibition and Regulation) Act, 1986
(viii) Payment of Wages Act, 1936
(ix) The Workmen’s Compensation Act, 1923

(d) Applicable State Laws

(e) Transaction based application

   (i) FEMA 1999
   (ii) FDI scheme

Individual checklists (time based and event based) may be prepared as a control system.

III. Individual responsibilities on compliances to be clearly defined

Responsibility with respect of compliances has to be clearly defined in the compliance management programme, which will enable the compliance officer to co-ordinate with the respective officials in respect of deviations if any. For example, person responsible for PF returns from HR department, person responsible for reports to be sent to NSE in respect of terminals etc. may be given clearly.

IV. Evaluation

Compliance management system should have a proper evaluation methodology through questionnaires to departmental heads etc. at regular intervals.

V. Bridging the gap between compliance in letter and compliance in letter and spirit

As we discussed compliance has to be carried out in letter and spirit. The compliance management system has to be made in such a manner that the compliance is made in letter and spirit.

VI. Updation

Updation of compliance management programme is very essential as and when there is any change in any of the applicable law.

CONCLUSION

It is tempting to view regulatory compliance as an end in itself – a hoop that business must jump through in order to secure its license to operate. The paradoxical view that regulation is both a blessing and a curse continues to be widely held among senior executives. While they recognise the need for protection in key areas, they are often frustrated by what they see as overly complex, unnecessary bureaucracy to achieve this goal. We must rise above a rules-based mindset that asks, 'Is this legal?' and adopt a more principles-based approach that asks, 'Is this right?'

Internal control has two components, internal check and internal audit. Internal control enables an entity to achieve desired performance, profitability, and prevent loss of resources through the effective internal checks supported by the internal audit.
Principles of Corporate Governance requires adherence to the applicable laws and regulations through adequate disclosures, transparency and reliable financial reporting. The law abiding entity improves the image among stakeholders, improved relations with regulators, and avoid pitfalls. All this may happen only due to perfect internal controls.

COSO has enunciated seventeen principles on internal control. The principles have been recognized world over. While it discusses the responsibility for establishing of the internal control measures in the organization, it also describes what internal control can do and what it cannot do. An internal control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance to management and the board regarding achievement of an entity's objectives. The likelihood of achievement is affected by limitations inherent in all internal control systems. These include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the collusion of two or more people, and management has the ability to override the system. Another limiting factor is that the design of an internal control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs.

**GLOSSARY OF TECHNICAL WORDS**

- **Compliance**: Compliance means acting in accordance with a request or a command, rule or instruction. Compliance can be narrowly defined to mean the process by which an organisation ensures that it observes and complies with the external statutory laws and regulations.

- **ICRM**: The Internal Compliance Reporting Mechanism (ICRM) is of paramount important that the employees working in the organisation shall feel free in reporting non-compliance related issues either by their own parts or has observed any deficiency on the counter part.

- **Money Laundering**: Money laundering is the act of concealing the transformation of profits from illegal activities and corruption into ostensibly “legitimate” assets. The dilemma of illicit activities is accounting for the origin of the proceeds of such activities without raising the suspicion of law enforcement agencies.

- **COSO**: “COSO” stands for the Committee of Sponsoring Organisation of the Treadway Commission.

**LESSON ROUND UP**

- A compliance management system is the method by which corporate manage the entire compliance process. It includes the compliance program, compliance audit, compliance report etc.

- A tool, which helps companies comply with provisions of various governing legislations as well as rules, regulations and guidelines issued thereunder, is a Compliance Solution.

- In the context of corporate governance, ethics is the intent to observe the spirit of law—in other words, it is the expressed intent to do what is right.

- Corporate Compliance Management can add substantial business value only if compliance is done with due diligence.

- The Company Secretary is the professional who guides the Board and the company in all matters, renders advice in terms of compliance and ensures that the Board procedures are duly followed, best global practices are brought in and the organisation is taken forward towards good corporate citizenship.
REFERENCE FOR FURTHER READING
https://traceinternational.org/Uploads/PublicationFiles/FirsttoKnow-RobustInternalReportingPrograms.pdf

SELF TEST QUESTIONS

1. Draft a Compliance Management programme for a Broking company.
2. Describe the scope of compliance management.
3. Explain compliance management process in general.
4. Explain the systems approach to compliance management.
Lesson 13
Internal Control

LESSON OUTLINE

• Introduction
• Nature of Internal Control
• Classification of Internal Control
• Elements of Internal Control
• Techniques of Internal Control System
• Steps for Internal Control
• Vigil Mechanism
• COSO’s Internal Control framework
• Roles and Responsibilities with regard to Internal Control
• Glossary
• Lesson Round-Up
• Self Test Questions

LEARNING OBJECTIVES

The objective of this study lesson is to enable the students to understand the concept of Internal Control, explaining the adequacy and effectiveness of the compliance system, internal compliance reporting mechanism and ensuring the best practices available for the good governance principles for compliance issues.

The concept of internal control, elements of internal control and its efficacy are discussed in this chapter.

This chapter provides working knowledge for application of principles, theory and concepts of internal control. This chapter may also be useful in performing the advisory role and in managing internal control in practical areas of work.
INTRODUCTION

Internal control, as defined in accounting and auditing, is a process for assuring achievement of an organization’s objectives in operational effectiveness and efficiency, reliable financial reporting, and compliance with laws, regulations and policies. It is a means by which an organization’s resources are directed, monitored, and measured. It plays an important role in detecting and preventing fraud and protecting the organization’s resources, both physical (e.g., machinery and property) and intangible (e.g., reputation or intellectual property such as trademarks).

It is to be mentioned here that internal control is not necessarily a control over finance only. Its scope is wider. It covers the control of the whole management system.

At the organizational level, internal control objectives relate to the reliability of financial reporting, timely feedback on the achievement of operational or strategic goals, and compliance with laws and regulations.

At the specific transaction level, internal controls refers to the actions taken to achieve a specific objective (e.g., how to ensure the organization’s payments to third parties are for valid services rendered.) Internal control procedures reduce process variation, leading to more predictable outcomes.

The International Standard on Auditing 315 (SA 315) defines internal control. According to SA 315 the internal control is “the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity’s objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. The term “controls” refers to any aspects of one or more of the components of internal control.”

NATURE OF INTERNAL CONTROL

The nature of internal control is to establish preventing measures in the organization. It follows the principle that key activities in the organisations should be processed by one person and be checked by the independent person so that mistake at one stage may be checked by another independent person. This prevents the occurrence of the fraud and so of deliberate attempts made any insider may be withheld at once. Thus the nature of the internal control is preventive.

From the definition provided by the SA 315 the nature of the internal control depicts the following points:

- Internal control is a process designed, implemented and maintained by those charged with the governance, management and other personnel.
- It provides reasonable assurance about the achievement of an entity’s objectives in the categories of financial reporting, effectiveness and efficiency of operations, safeguarding of assets and compliance with applicable laws and regulations.

CLASSIFICATION OF INTERNAL CONTROL

Internal control can broadly be classified into two categories viz.:

1. Accounting controls/financial controls, and
2. Administrative controls.

(1) Accounting controls

Accounting controls comprise the plan of organisation and all methods and procedures that are concerned
mainly with and relate to, the safeguarding of assets and the reliability of the financial information. They generally include such controls as the system of authorisation and approval, separation of duties concerned with record keeping and accounting reports from those concerned with operations of assets custody, physical controls over assets and internal auditing e.g. budgetary controls.

Examples of each are (i) maintaining inventory is an accounting control whereas (ii) recording of visits by a salesman is the administrative control.

Internal control relating to accounting system aims at ensuring that:

- the transactions are executed in accordance with the management’s authorisation;
- all transactions are promptly recorded in an appropriate manner to permit the preparation of financial information and to maintain accountability for assets;
- the access to assets is permitted only in accordance with the management authorisation;
- the assets are reviewed and verified at reasonable intervals and appropriate action is taken with regard to the variances.

It can safely be said that scope of internal control is much wider than that of accounting controls. Thus, internal checks, internal audit, quantitative controls, budgetary controls etc. can be said to be a part of the accounting controls, in so far as they deal with quantitative aspects. On a wider footing, accounting controls, operational controls, policy planning/review, reporting etc. can be said to be a part of internal control.

(2) Administrative Controls

A number of controls falling under operational controls can also be administrative controls. Examples of operational controls are: quality control, works standards, periodic reporting, policy appraisal etc. Administrative controls are very wide in their scope. They include all other managerial controls concerned with decision-making process. They are concerned with the authorisation of transactions and include anything from plan of organisation to procedures, record keeping, distribution of authority and the process of decision-making. They include controls such as time and motion studies, quality control through inspection, performance budgeting, responsibility accounting and performance evaluation etc. Administrative controls have an indirect relationship with financial records and the auditor may evaluate only those administrative controls which have a bearing on the financial records.

However, for the purposes of understanding the internal control we may study it in four parts as:

1. Accounting controls
2. Operational controls
3. Internal checks
4. Internal audit.

These are explained below summarily for a better comprehension of the subject, even though at the cost of repetition.

1. Accounting controls pertain purely to the accounting system which enter finally in the preparation of financial statements and information which are subject to the expression of opinion by the auditors.

2. Operational controls are those which help in improving the efficiency, productivity and not necessarily enter the accounting systems. Works standards, quality control, methods study and motion study, critical path method etc. may be many examples of operational controls.
3. Internal check is a built-in device in the day-to-day working by separating the duties and functions of the staff in such a way that the work of one is automatically checked by the other e.g. posting of cash transactions in the ledger is done by a person other than who handles the cash and writes the cash book — the cashier. This part shall be dealt with subsequently in detail.

4. Internal audit is an appraisal function to be performed on the principles and practices of audit. The scope of this extends to all the quantifiable information.

**ELEMENTS OF INTERNAL CONTROL**

The essential requirements for the success of a business are the implementation of organisational objectives, plans and philosophy. With this end in view the following may be considered as the elements of internal control.

(i) Segregation of duties

The division of an operation into a series of sub-operations undertaken by different people, allows for internal checks to take place. Such a control merely reduces the chance of error or irregularity occurring, but it does not eliminate the risk. It reduces the risk of intentional manipulation and error and increases the element of checking. Function which should be separated includes those of authorisation, execution, custody, recording and in the case of a computer-based accounting system—systems development and daily operations.

(ii) Organisational structure

The structure or pattern of an organisation will mean system of arrangements and relations as between various levels of personnel for carrying out of plans and policies towards achievement of objectives for which the business stands. Enterprises should have a plan of their organisation, defining and allocating responsibilities and identifying lines of reporting for all aspects of the enterprise’s operations, including the controls. The delegation of authority and responsibility should be clearly specified. It is important that critical operations are provided with the appropriate status and communications within the organisations. A common cause of irregularity is imbalance between responsibility, status and remuneration.

(iii) Objectives and Policy Statements

Objectives are the aims, goals, purposes or accomplishments which the top management lay down and expect the staff members to achieve. The functional segments of the company should comply with the policies, plans, procedures, external laws and regulations and the work should be performed in a coordinated manner.

Policies and procedures give an indication as to the nature of personnel behaviour in their functioning and reflect the attitude of management. Functions of different staff members should be integrated in a manner that is complementary and each acts as check on the other. For instance, wage sheets should be prepared and checked by different sets of staff and their disbursement should be in the presence of a responsible official.

(iv) Authorisation and approval

All transactions should require authorisation or approval by an appropriate responsible person. The limits of these authorisations should be specified. While designing procedures, provision should be made for proper authorization, to establish full accountability for the actions taken.

(v) Personnel

There should be procedures to ensure that personnel have capabilities commensurate with their
responsibilities. In fact, the proper functioning of any system depends on the competence and integrity of those operating it. The qualifications, selection and training as well as the innate personal characteristics of the personnel involved are important features to be considered in setting up any control system.

(vi) Management

Management is responsible for establishing, monitoring and reviewing the systems of internal control. In practice, management may delegate the reviewing function to internal auditor. It is, thus the duty of internal auditor to provide management with reassurance concerning the efficiency and effectiveness of internal controls.

(vii) Records and Reports

The accounting and other records should be maintained accurately and adequately so as to assist the management in formulating present and future events in decision making and planning.

In order to make reporting effective, it should be timely, tailor-made and present all facts concerning problem areas, assessments etc.

(viii) Accounting Controls

These are the controls within the recording function which check that the transactions to be recorded and processed have been authorised, and that they are all included and that they are correctly recorded and accurately processed. Such controls include checking the arithmetical accuracy of the records, the maintenance and checking of totals, reconciliations, control accounts and trial balances, and accounting for documents.

(ix) Protection of assets

These are concerned mainly with the custody of assets and involve procedures and security measures designed to ensure that access to assets is limited to authorised personnel. These include both direct access and indirect access via documentation. These controls assume importance in the case of valuable, portable, exchangeable or desirable assets.

(x) Supervision

Any system of internal control should include the supervision by responsible officials of day-to-day transactions and the recording thereof. The supervisory role undertaken by staff should be allocated to those with proper training and suitability to such a function.

Components of Internal Control

The internal control system may involve the following points to support the achievement of an entity’s mission, strategies and related business objectives. The Appendix 1 of SA 315 provides the Internal Control Components. These are described as under:

1. Control Environment:

The control environment encompasses the following elements:

(a) Communication and enforcement of integrity and ethical values. The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Integrity and ethical behavior are the product of the entity’s ethical and behavioral standards,
how they are communicated, and how they are reinforced in practice. The enforcement of integrity and ethical values includes, for example, management actions to eliminate or mitigate incentives or temptations that might prompt personnel to engage in dishonest, illegal, or unethical acts. The communication of entity policies on integrity and ethical values may include the communication of behavioral standards to personnel through policy statements and codes of conduct and by example.

(b) Commitment to competence. Competence is the knowledge and skills necessary to accomplish tasks that define the individual’s job.

(c) Participation by those charged with governance. An entity’s control consciousness is influenced significantly by those charged with governance. The importance of the responsibilities of those charged with governance is recognized in codes of practice and other laws and regulations or guidance produced for the benefit of those charged with governance. Other responsibilities of those charged with governance include oversight of the design and effective operation of whistle blower procedures and the process for reviewing the effectiveness of the entity’s internal control.

(d) Management’s philosophy and operating style. Management’s philosophy and operating style encompass a broad range of characteristics. For example, management’s attitudes and actions toward financial reporting may manifest themselves through conservative or aggressive selection from available alternative accounting principles, or conscientiousness and conservatism with which accounting estimates are developed.

(e) Organizational structure. Establishing a relevant organizational structure includes considering key areas of authority and responsibility and appropriate lines of reporting. The appropriateness of an entity’s organizational structure depends, in part, on its size and the nature of its activities.

(f) Assignment of authority and responsibility. The assignment of authority and responsibility may include policies relating to appropriate business practices, knowledge and experience of key personnel, and resources provided for carrying out duties. In addition, it may include policies and communications directed at ensuring that all personnel understand the entity’s objectives, know how their individual actions interrelate and contribute to those objectives, and recognize how and for what they will be held accountable.

(g) Human resource policies and practices. Human resource policies and practices often demonstrate important matters in relation to the control consciousness of an entity. For example, standards for recruiting the most qualified individuals – with emphasis on educational background, prior work experience, past accomplishments, and evidence of integrity and ethical behavior – demonstrate an entity’s commitment to competent and trustworthy people. Training policies that communicate prospective roles and responsibilities and include practices such as training schools and seminars illustrate expected levels of performance and behavior. Promotions driven by periodic performance appraisals demonstrate the entity’s commitment to the advancement of qualified personnel to higher levels of responsibility.

2. Entity’s Risk Assessment Process

For financial reporting purposes, the entity’s risk assessment process includes how management identifies business risks relevant to the preparation of financial statements in accordance with the entity’s applicable financial reporting framework, estimates their significance, assesses the likelihood of their occurrence, and decides upon actions to respond to and manage them and the results thereof. For example, the entity’s risk assessment process may address how the entity considers the possibility of unrecorded transactions or identifies and analyzes significant estimates recorded in the financial statements.
Risks relevant to reliable financial reporting include external and internal events, transactions or circumstances that may occur and adversely affect an entity's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. Management may initiate plans, programs, or actions to address specific risks or it may decide to accept a risk because of cost or other considerations. Risks can arise or change due to circumstances such as the following:

- Changes in operating environment: Changes in the regulatory or operating environment can result in changes in competitive pressures and significantly different risks.
- New personnel: New personnel may have a different focus on or understanding of internal control. New or revamped information systems: Significant and rapid changes in information systems can change the risk relating to internal control.
- Rapid growth: Significant and rapid expansion of operations can strain controls and increase the risk of a breakdown in controls.
- New technology: Incorporating new technologies into production processes or information systems may change the risk associated with internal control.
- New business models, products, or activities: Entering into business areas or transactions with which an entity has little experience may introduce new risks associated with internal control.
- Corporate restructurings: Restructurings may be accompanied by staff reductions and changes in supervision and segregation of duties that may change the risk associated with internal control.
- Expanded foreign operations: The expansion or acquisition of foreign operations carries new and often unique risks that may affect internal control, for example, additional or changed risks from foreign currency transactions.
- New accounting pronouncements: Adoption of new accounting principles or changing accounting principles may affect risks in preparing financial statements.

3. Information System, Including the Related Business Processes, Relevant to Financial Reporting, and Communication:

An information system consists of infrastructure (physical and hardware components), software, people, procedures, and data. Many information systems make extensive use of information technology (IT).

The information system relevant to financial reporting objectives, which includes the financial reporting system, encompasses methods and records that:

- Identify and record all valid transactions.
- Describe on a timely basis the transactions in sufficient detail to permit proper classification of transactions for financial reporting.
- Measure the value of transactions in a manner that permits recording their proper monetary value in the financial statements.
- Determine the time period in which transactions occurred to permit recording of transactions in the proper accounting period.
- Present properly the transactions and related disclosures in the financial statements.
The quality of system-generated information affects management’s ability to make appropriate decisions in managing and controlling the entity’s activities and to prepare reliable financial reports.

Communication, which involves providing an understanding of individual roles and responsibilities pertaining to internal control over financial reporting, may take such forms as policy manuals, accounting and financial reporting manuals, and memoranda. Communication also can be made electronically, orally, and through the actions of management.

4. Control Activities:

Generally, control activities that may be relevant to an audit may be categorized as policies and procedures that pertain to the following:

- **Performance reviews:** These control activities include reviews and analyses of actual performance versus budgets, forecasts, and prior period performance; relating different sets of data – operating or financial – to one another, together with analyses of the relationships and investigative and corrective actions; comparing internal data with external sources of information; and review of functional or activity performance.

- **Information processing:** The two broad groupings of information systems control activities are application controls, which apply to the processing of individual applications, and general IT controls, which are policies and procedures that relate to many applications and support the effective functioning of application controls by helping to ensure the continued proper operation of information systems. Examples of application controls include checking the arithmetical accuracy of records, maintaining and reviewing accounts and trial balances, automated controls such as edit checks of input data and numerical sequence checks, and manual follow-up of exception reports. Examples of general IT controls are program change controls, controls that restrict access to programs or data, controls over the implementation of new releases of packaged software applications, and controls over system software that restrict access to or monitor the use of system utilities that could change financial data or records without leaving an audit trail.

- **Physical controls:** Controls that encompass:
  - The physical security of assets, including adequate safeguards such as secured facilities over access to assets and records.
  - The authorization for access to computer programs and data files.
  - The periodic counting and comparison with amounts shown on control records (for example, comparing the results of cash, security and inventory counts with accounting records).
  - The extent to which physical controls intended to prevent theft of assets are relevant to the reliability of financial statement preparation, and therefore the audit, depends on circumstances such as when assets are highly susceptible to misappropriation.
  - Segregation of duties: Assigning different people the responsibilities of authorizing transactions, recording transactions, and maintaining custody of assets. Segregation of duties is intended to reduce the opportunities to allow any person to be in a position to both perpetrate and conceal errors or fraud in the normal course of the person’s duties.

- **Certain control activities may depend on the existence of appropriate higher level policies established by management or those charged with governance.** For example, authorization controls may be delegated under established guidelines, such as investment criteria set by those charged with governance; alternatively, non-routine transactions such as major acquisitions or divestments may require specific high level approval, including in some cases that of shareholders.
5. Monitoring of Controls:

An important management responsibility is to establish and maintain internal control on an on-going basis. Management's monitoring of controls includes considering whether they are operating as intended and that they are modified as appropriate for changes in conditions. Monitoring of controls may include activities such as management’s review of whether bank reconciliations are being prepared on a timely basis, internal auditors’ evaluation of sales personnel’s compliance with the entity’s policies on terms of sales contracts, and a legal department’s oversight of compliance with the entity’s ethical or business practice policies. Monitoring is done also to ensure that controls continue to operate effectively over time. For example, if the timeliness and accuracy of bank reconciliations are not monitored, personnel are likely to stop preparing them.

Internal auditors or personnel performing similar functions may contribute to the monitoring of an entity’s controls through separate evaluations. Ordinarily, they regularly provide information about the functioning of internal control, focusing considerable attention on evaluating the effectiveness of internal control, and communicate information about strengths and deficiencies in internal control and recommendations for improving internal control.

Monitoring activities may include using information from communications from external parties that may indicate problems or highlight areas in need of improvement. Customers implicitly corroborate billing data by paying their invoices or complaining about their charges. In addition, regulators may communicate with the entity concerning matters that affect the functioning of internal control, for example, communications concerning examinations by bank regulatory agencies. Also, management may consider communications relating to internal control from external auditors in performing monitoring activities.

Limitations of Internal Control (as laid down by SA 315)

The limitations of Internal Control as laid down by SA 315 are:

- Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity’s financial reporting objectives. The likelihood of their achievement is affected by the inherent limitations of internal control. These include the realities that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human error. For example, there may be an error in the design of, or in the change to, a control. Equally, the operation of a control may not be effective, such as where information produced for the purposes of internal control (for example, an exception report) is not effectively used because the individual responsible for reviewing the information does not understand its purpose or fails to take appropriate action.

- Additionally, controls can be circumvented by the collusion of two or more people or inappropriate management override of internal control. For example, management may enter into side agreements with customers that alter the terms and conditions of the entity’s standard sales contracts, which may result in improper revenue recognition. Also, edit checks in a software program that are designed to identify and report transactions that exceed specified credit limits may be overridden or disabled.

- Further, in designing and implementing controls, management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.

Techniques of Internal Control System

Any business that hires employees runs the risk of fraudulent activity. Fraud can have a large negative impact on one’s business’s bottom line. In some cases, a trusted employee who has easy access to a
business’s finances may abuse his authority by stealing company funds. A variety of internal control techniques can help prevent improprieties. The following points in this regard are worth mentioned:

- There should be clear division of the work.
- Segregation of the work should be in such a manner that the work done by one person is the beginning of the work for another person.
- There should be the clarity of the responsibility.
- The work flow process be documented or standardized so that the staff may perform the work as suggested in the work flow chart.
- No single persons should be allowed to have access or control over any important business operation.
- There should be job rotation of the staff duties periodically.
- Staff should be asked to go on mandatory leave periodically so that other person may come to know if someone is playing foul with the system.
- Persons having the charge of the important assets should not be allowed to have access to the books of accounts.
- Periodical inspection of the physical assets be carried out to ensure its physical existence as well in good working conditions.
- The valuable items like cash and others, by physically inspected and the periodicity should be at irregular intervals, so that the person under whose charge the assets are, cannot know in advance, when the inspection will took place and manage the affairs.

Section 177(5) of the Companies Act, 2013 provides that the Audit Committee may call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.

SEBI (LODR) Regulations also provide that directors’ report should include a Management Discussion and Analysis report. This Management Discussion & Analysis Report, apart from other points should also comment on the Internal control systems and their adequacy.

The following methods are adopted for Internal Control in modern organisation:

(1) Internal Check
(2) Internal Audit
(3) Flow Charts
(4) Internal Control Questionnaire
(5) Inter firm and Intra firm Comparisons.

(1) Internal Check

Accurate, complete and reliable record of accounting is a pre-requisite of good working of an organisation. The allocation of duties and responsibilities of an organisation should be such that the working is proved trustworthy. To help it further, the procedures and methods should also be designed accordingly.

Internal check has been defined differently by different authors and institutions connected with subject. The
Institute of Chartered Accountants of England and Wales defines internal check as the allocation of authority and work in such a manner as to effort the checks on the day to day transactions which operate continuously as part of routine system whereby the work of one person is automatically proved independently or is complementary to the work of another, the object being prevention or early detection of error and frauds.

It is also defined as those measures and methods adopted within the organisation itself to safeguard the cash and other assets of the company as well as to check clerical accuracy of book keeping.

Thus, the term 'internal check' refers to allocation of duties in such a manner that the work of one person is checked by another while that other is performing his own duties in a normal way. Internal check is the organisation of duties of staff in a scientific way so that no one is responsible for all phases of the transaction and the work of one employee is so distributed that the discrepancies are revealed in the process of performance of duties of that employee. The duties are divided and sub-divided in such a manner that discrepancies flow out from the system itself.

Briefly speaking, the internal check system may be referred to as a system of instituting checks on the day-to-day transactions which operate continuously as a part of routine system whereby the work of one person is complementary to the work of another, the object being the prevention or early detection of errors or fraud. The objective of such allocation of duties is that no single individual has an exclusive control over any one transaction or group of transactions.

The following are the important objects of internal check system:

(i) To assign to a specific person, the responsibility of particular acts, defaults or omissions by allocation of specific duties.

(ii) To obtain physical and financial confirmation of facts and entries physical and financial by creation and preservation of necessary records.

(iii) To facilitate the breakdown of accounting procedures where required so as to avoid bottlenecks and establish an even flow of work and operations.

(iv) To reduce the possibilities of fraud and errors.

The main purpose of introducing internal check is ensured by division of labour. The internal check should be arranged after the proper study of the requirement of each business.

As specified by Special Committee on Terminology, American Institute of Accountants, “Internal check—a system under which the accounting methods and details of an establishment are so laid out that the accounts and procedures are not under the absolute and independent control of any person - that on the contrary, the work of an employee is complementary to that of another and that a continuous audit of the business is made by the employees”.

**Essential Features of Internal Check**

Essential features of internal check are given hereunder:

(1) There should be proper division of work and responsibilities.

(2) The duties of each person should be properly defined so as to fix definite responsibilities of each individual.

(3) Possibilities of giving absolute control to anybody should not be left unchecked.

(4) Too much confidence on a person should be avoided.
(5) The duties of staff should be rotated and one person should not be allowed to occupy a particular area of operation for long.

(6) Necessary safeguards should be provided so as to avoid collusion of thoughts which quite often leads to commission of fraud.

(7) The person handling cash, stock, securities should be given compulsory leave so as to prevent their having uninterrupted control.

(8) Physical inventory of fixed assets and stocks should be taken periodically.

(9) Assets should be protected from unauthorised use.

(10) To prevent loss or misappropriation of cash, mechanical devices such as the automatic cash register, should be employed.

(11) The financial and administrative powers should be distributed very judiciously among different officers and the manner in which these are actually exercised should be reviewed periodically.

(12) Accounting procedures should be laid down for periodical verification and testing of different sections of accounting records to ensure that they are accurate.

For introducing any system of internal check the work should be allotted on the basis of specialisation. The grey area where internal check could prove to be of much help are receipts and payments of cash, payment of wages, credit purchases etc. The nature and size of operation should also be given consideration while installing or introducing internal check system in any organisation. The success of internal check system would, by and large, depend upon the in-built safeguards introduced in the system. Instituting internal check system would reduce the work load of the auditor and make the accounting system more reliable. The internal check is of great importance to small as well as large companies, although this method of operation will necessarily vary from that adopted in major concerns. In small organisation the number of employees is too few to establish an adequate division of duties so that supervisors or owners must claim more responsibility.

It is of importance that accounting procedures and working in any organisation is liable to changes and the system of internal check will have to be modified to suit the changed conditions. The pitfalls in the system are a warning to the auditor that something is wrong. If he disregards such a warning by failing to make the additional tests necessitated by the disclosed weaknesses he will not be able to perform his duties well and is liable to commit mistakes.

(2) Internal Audit

Internal auditing though part of an internal control is a function in itself as administration, production, personnel, marketing etc. Whereas internal check devises the form and flow of operations of an entity so that automatic checks are carried out as the transactions occur; internal audit is a critical appraisal of functioning of various operations of an enterprise including the system of internal check. This is evident in its definition itself as “an independent appraisal function”.

‘Internal auditing’ in its traditional parlance, meant an audit on behalf of management to ensure only: (a) the adequacy and effectiveness of internal controls; (b) accuracy and timeliness of financial and other records and reports; (c) adherence to the laid down policies and procedures by each unit of the organisation. Thus, with major emphasis on detection of frauds and ensuring accuracy of financial records, internal auditing was merely concerned with financial security by conducting routine checks. However, the modern world has witnessed dynamic changes in the manner of conducting activities by industrial and commercial
organisations. Fast rising wages, increasing costs, cut throat competition, government's regulatory policies and globalisation have resulted in management's search for all round improvements, efficiency, economy and making an endeavour to provide the society with the best products at the most economical prices. As a result, the scope of internal auditing has been progressively widened to circumscribe a complete intra-company financial and operational review and fulfill its role as a tool of effective management control.

The Institute of Internal Auditors has defined internal audit as under:

"Internal audit is an independent appraisal activity established within an organisation to examine and evaluate the activities as a service to the organisation. The objective of internal audit is to assist members of the organisation in the effective discharge of their responsibilities. To this end, the internal auditor furnishes them with analyses, appraisal, recommendations, counsel and information concerning the activities reviewed."

It is seen that internal auditing is not only confined to traditional functions like review of custodianship, safeguarding of assets and checking the reliability of accounting information but also encompasses new areas like review of economical and efficient use of resources and ensuring optimum organizational performance. It is thus:

1. an independent appraisal function;
2. established within the organization;
3. to examine and evaluate the activities as a service to the management;
4. to assist the members for effective discharge of their responsibilities;
5. to furnish with analyses, appraisals, suggestions etc.

The scope of internal auditing within an organization is broad and may involve topics such as an organization's governance, risk management and management controls over: efficiency/effectiveness of operations (including safeguarding of assets), the reliability of financial and management reporting, and compliance with laws and regulations. Internal auditing may also involve conducting proactive fraud audits to identify potentially fraudulent acts; participating in fraud investigations under the direction of fraud investigation professionals, and conducting post investigation fraud audits to identify control breakdowns and establish financial loss.

The following are the main aspects of internal auditing:

1. Review, appraisal and evaluation of the soundness, adequacy and application of financial, accounting and other operating controls.
2. Ascertaining the adequacy and reliability of management information and control systems.
3. Ascertaining the achievement of management objectives and compliance with established plans, policies and procedures.
4. Ensuring proper safeguards for assets - their utilization and accounting thereof.
5. Detection and prevention of fraud and error.
6. Ascertaining the integrity of management data in an organisation.
7. Identifying the areas of cost reduction, coupled with increased production, improved productivity and improved systems.
8. Ascertaining the quality of performance and undertaking 'value for money' exercises.
9. Compliance with statutory laws and rules including adherence to the Companies (Auditors’ Report) Order, 2003 to avoid adverse comments from the statutory auditors.

10. Undertaking special reviews and assignments directed by management to ensure economical and efficient use of resources.

11. To provide for a channel of communicating new ideas to the top management.

Over the last few years, the need to manage risks has become recognised as an essential part of good corporate governance practice. This has put organisations under increasing pressure to identify all the business risks they face and to explain how they manage them. In fact, the activities involved in managing risks have been recognised as playing a central and essential role in maintaining a sound system of internal control. While the responsibility for identifying and managing risks belongs to management, one of the key roles of internal audit is to provide assurance that those risks have been properly managed.

Risk based Internal Audit (RBIA) is an internal methodology which is primarily focused on the inherent risk involved in the activities or system and provide assurance that risk is being managed by the management within the defined risk appetite level. It is the risk management framework of the management and seeks at every stage to reinforce the responsibility of management and BOD (Board of Directors) for managing risk.

Existing in the fast changing business environment the biggest challenge the Internal Audit currently faces is whether it is now in a position to add value to an organization. Economic events in the recent history of global financial markets emphasized the importance of management understanding the risks facing an organization and the impact of not implementing an effective risk management process. Internal audit functions historically followed a compliance based approach that adds little value with organizations now facing ever changing risks. Heading in the right direction of alignment with corporate objectives and adding value to the business the Internal Audit function is becoming one of the critical functions finding its justified place within corporate

**STEPS FOR INTERNAL CONTROL**

In order to establish the internal control mechanism the following points are to be kept in view:

- Identify the key areas where the internal control mechanism is to be established.
- Every work flow should be so documented that it is not complete if another person has not checked it out.
- The other person’s role should start when the first person’s role comes to an end.
- Establish the surprise check mechanism where the money matters are involved.
- Reporting of the non-adherence of key compliance areas.
- Review mechanism of the control units.
- Establishment of Vigil Mechanism: The organization should establish a vigil mechanism as per the provisions of Rule 7 of the companies (Meetings of board and its Powers) Rules 2014. The relevant rule and its applicability is appended below:

**VIGIL MECHANISM**

Rule 7 of the Companies (Meetings of Board and its Powers) Rules, 2014 provides that every listed company and the companies belonging to the following class or classes shall establish a vigil mechanism for their directors and employees to report their genuine concerns or grievances:
(a) the Companies which accept deposits from the public;
(b) the Companies which have borrowed money from banks and public financial institutions in excess of fifty crore rupees.

(2) The companies which are required to constitute an audit committee shall oversee the vigil mechanism through the committee and if any of the members of the committee have a conflict of interest in a given case, they should recuse themselves and the others on the committee would deal with the matter on hand.

(3) In case of other companies, the Board of directors shall nominate a director to play the role of audit committee for the purpose of vigil mechanism to whom other directors and employees may report their concerns.

(4) The vigil mechanism shall provide for adequate safeguards against victimisation of employees and directors who avail of the vigil mechanism and also provide for direct access to the Chairperson of the Audit Committee or the director nominated to play the role of Audit Committee, as the case may be, in exceptional cases.

(5) In case of repeated frivolous complaints being filed by a director or an employee, the audit committee or the director nominated to play the role of audit committee may take suitable action against the concerned director or employee including reprimand.

**COSO’S INTERNAL CONTROL FRAMEWORK**

COSO is the abbreviation of, The Committee of Sponsoring Organizations of the Treadway Commission (COSO). It is a joint initiative of the five private sector organizations (American Accounting Association, American Institute of CPA, Financial Executives International, The Association of Accountants and Financial Professionals in Business and The Institute of Internal Auditors) and is dedicated to providing thought leadership through the development of frameworks and guidance on enterprise risk management, internal control and fraud deterrence.

In 1992 the COSO released its Internal Control—Integrated Framework (the original framework). In the twenty years since the inception of the original framework, business and operating environments have changed dramatically, becoming increasingly complex, technologically driven, and global. At the same time, stakeholders are more engaged, seeking greater transparency and accountability for the integrity of systems of internal control that support business decisions and governance of the organization.

On May 14, 2013, COSO released its revisions and updates to the 1992 document Internal Control - Integrated Framework. COSO’s goal in updating the framework was to increase its relevance in the increasingly complex and global business environment so that organizations worldwide can better design, implement, and assess internal control. COSO believes this framework will provide organizations significant benefits; for example, increased confidence that controls mitigate risks to acceptable levels and reliable information supporting sound decision making.

As per definition given by COSO, the Internal control is a process, effected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance.

The fundamental concepts from the definition of Internal Control are:

- Geared to the achievement of objectives in one or more separate but overlapping Categories.
- A process consisting of ongoing tasks and activities—it is a means to an end, not an end in itself.
• Effected by people—it is not merely about policy and procedure manuals, systems, and forms, but about people and the actions they take at every level of an organization to effect internal control.

• Able to provide reasonable assurance, not absolute assurance, to an entity’s senior management and board of directors.

• Adaptable to the entity structure—flexible in application for the entire entity or for a particular subsidiary, division, operating unit, or business process.

COSO’s Internal Control Framework includes enhancements and clarifications that are intended to ease use and application. One of the more significant enhancements is the formalization of fundamental concepts introduced in the original framework as principles. These principles, associated with the five components, provide clarity for the user in designing and implementing systems of internal control and for understanding requirements for effective internal control.

The Framework has been enhanced by expanding the financial reporting category of objectives to include other important forms of reporting, such as non-financial and internal reporting. Also, the Framework reflects considerations of many changes in the business, operating, and regulatory environments over the past several decades, including:

• Expectations for governance oversight.

• Globalization of markets and operations.

• Changes and greater complexity in the business.

• Demands and complexities in laws, rules, regulations, and standards.

• Expectations for competencies and accountabilities.

• Use of, and reliance on, evolving technologies.

• Expectations relating to preventing and detecting fraud.

Objectives: The Framework sets forth three categories of objectives, which allow organizations to focus on separate aspects of internal control:

• Operations Objectives: These pertain to effectiveness and efficiency of the entity’s operations, including operational and financial performance goals, and safeguarding assets against loss.

• Reporting Objectives: These pertain to internal and external financial and non-financial reporting and may encompass reliability, timeliness, transparency, or other terms as set forth by regulators, standard setters, or the entity’s policies.

• Compliance Objectives: These pertain to adherence to laws and regulations to which the entity is subject.

Components of Internal Control: When we talk about the Internal Control, two key phrase comes to our mind i.e. (i) internal check and (ii) internal audit. Let us have a brief synopsis about the internal check and internal audit.

(i) Internal Check: Internal check means an arrangement that a transaction is process by two or more persons and each one is independent and starts with when the predecessor has completed the task. So, it is a self balancing system, which have the in-built systems of independent checking of the work done by other.

(ii) Internal Audit: The second important aspect is the internal audit. Internal audit may be done by the
own staff or by engaging any professional person outside of the organisation. The scope of the internal audit is determined by the management. Internal Auditor is required to submit its report to the management (who is appointing authority). The report should inter alia cover the points relating to the, adequacy of the internal check and control systems, adherence to the established management controls, maintenance of the records and reports on the financial accounting etc. The internal audit should be carried out of all the Departments of the organisations and before start of the audit, the auditor should well understand the plans, policies and procedures of the Dept/Firm in order to find the job specifications, its descriptions and accountability.

**Relationship of Objectives and Control**

A direct relationship exists between objectives, which are what an entity strives to achieve, components, which represent what is required to achieve the objectives, and entity structure (the operating units, legal entities, and other structures).

![COSO's Internal Control - Integrated Framework](image)

The relationship can be depicted in the form of a cube.

- The three categories of objectives are represented by the columns.
- The five components are represented by the rows.
- The entity structure, which represents the overall entity, divisions, subsidiaries, operating units, or functions, including business processes such as sales, purchasing, production, and marketing and to which internal control relates, are depicted by the third dimension of the cube.

Each component cuts across and applies to all three categories of objectives. For example, selecting policies and procedures that help ensure that management’s statements, actions, and decisions are carried out—part of the control activities component—are relevant to all three objectives categories.

The three categories of objectives are not parts or units of the entity. For instance, operations objectives
relate to the efficiency and effectiveness of operations, not specific operating units or functions such as sales, marketing, procurement, or human resources.

Accordingly, when considering the category of objectives related to reporting, for example, knowledge of a wide array of information about the entity’s operations is needed. In that case, focus is on the middle column of the model—reporting objectives—rather than the operations objectives category.

Internal control is a dynamic, iterative, and integrated process. For example, risk assessment not only influences the control environment and control activities, but also may highlight a need to reconsider the entity’s requirements for information and communication, or for its monitoring activities. Thus, internal control is not a linear process where one component affects only the next. It is an integrated process in which components can and will impact another.

No two entities will, or should, have the same system of internal control. Entities, objectives, and systems of internal control differ dramatically by industry and regulatory environment, as well as by internal considerations such as the size, nature of the management operating model, tolerance for risk, reliance on technology, and competence and number of personnel. Thus, while all entities require each of the components to maintain effective internal control over their activities, one entity's system of internal control usually looks different from another’s.

**Control Testing and Evaluation**

One central element of COSO's updated framework is its continued emphasis on the linkage among objectives, risk, and control. Organizations seek to accomplish objectives, and those objectives need to be articulated. There are risks to achieving the objectives, whether they relate to operations, compliance, or reporting, and those risks need to be identified. The key is to link controls to risks and objectives: The only reason that controls exist is to mitigate risks and thereby increase the probability that the organization will accomplish its objectives. Control, therefore, is subservient to risk—and to the objectives they help achieve.

**Efficacy of Internal Controls and its Review**

The internal control should be adequate to cover all the key and sensitive areas of the organization. No one person should be allowed to complete one set of transactions. The control mechanism once established should be reviewed periodically in order to assess the lacunas and to remove the same. The password sharing should be strictly prohibited and stringent action should be taken against the erring staff. The efficacy of the internal control mechanism depends when the employees accepts this philosophy in the true letter and spirit.

**What Internal Control Can Do:**

- Internal control can help an entity achieve its performance and profitability targets, and prevent loss of resources.
- It can help ensure reliable financial reporting.
- It can help ensure that the enterprise complies with laws and regulations, avoiding damage to its reputation and other consequences.
- In sum, it can help an entity get to where it wants to go, and avoid pitfalls and surprises along the way.

**Limitation of Internal control**

- Internal control cannot change an inherently poor manager into a good one.
- Internal control cannot ensure success, or even survival in case of shifts in government policy or programs, competitors’ actions or economic conditions, since these are beyond the management's control.
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- An internal control system, no matter how well conceived and operated, can provide only reasonable—not absolute—assurance to management and the board regarding achievement of an entity's objectives.
- The likelihood of achievement is affected by limitations inherent in all internal control systems.
- Controls can be circumvented by the collusion of two or more people, and management has the ability to override the system.
- Another limiting factor is that the design of an internal control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs.
- Thus, while internal control can help an entity achieve its objectives, it is not a panacea.

**ROLE AND RESPONSIBILITIES WITH REGARD TO INTERNAL CONTROL**

Everyone in an organization has responsibility for internal control.

**Management:** The chief executive officer is ultimately responsible and should assume "ownership" of the system. More than any other individual, the chief executive sets the "tone at the top" that affects integrity and ethics and other factors of a positive control environment. In a large company, the chief executive fulfills this duty by providing leadership and direction to senior managers and reviewing the way they're controlling the business. Senior managers, in turn, assign responsibility for establishment of more specific internal control policies and procedures to personnel responsible for the unit's functions. In a smaller entity, the influence of the chief executive, often an owner-manager is usually more direct. In any event, in a cascading responsibility, a manager is effectively a chief executive of his or her sphere of responsibility. Of particular significance are financial officers and their staffs, whose control activities cut across, as well as up and down, the operating and other units of an enterprise.

**SEBI (LODR) Regulations, 2015**

The CEO or the Managing Director or manager or in their absence, a Whole Time Director appointed in terms of Companies Act, 2013 and the CFO shall certify to the Board that:

A. They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief:
   1. these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;
   2. these statements together present a true and fair view of the company's affairs and are in compliance with existing accounting standards, applicable laws and regulations.

B. There are, to the best of their knowledge and belief, no transactions entered into by the company during the year which are fraudulent, illegal or violative of the company's code of conduct.

C. They accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of internal control systems of the company pertaining to financial reporting and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of such internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.

D. They have indicated to the auditors and the Audit committee:
   1. significant changes in internal control over financial reporting during the year;
   2. significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and
Board of Directors: Management is accountable to the board of directors, which provides governance, guidance and oversight. Effective board members are objective, capable and inquisitive. They also have a knowledge of the entity's activities and environment, and commit the time necessary to fulfill their board responsibilities. Management may be in a position to override controls and ignore or stifle communications from subordinates, enabling a dishonest management which intentionally misrepresents results to cover its tracks. A strong, active board, particularly when coupled with effective upward communications channels and capable financial, legal and internal audit functions, is often best able to identify and correct such a problem.

Companies Act 2013 Section 134(5) (e)

The Directors’ Responsibility Statement referred shall state that— the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.

Explanation.—For the purposes of this clause, the term “internal financial controls” means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

Internal Auditors: Internal auditors play an important role in evaluating the effectiveness of control systems, and contribute to ongoing effectiveness. Because of organizational position and authority in an entity, an internal audit function often plays a significant monitoring role.

Other Personnel: Internal control is, to some degree, the responsibility of everyone in an organization and therefore should be an explicit or implicit part of everyone’s job description. Virtually all employees produce information used in the internal control system or take other actions needed.

CONCLUSION

Internal control has two components, internal check and internal audit. Internal control enables an entity to achieve desired performance, profitability, and prevent loss of resources through the effective internal checks supported by the internal audit.

Principles of Corporate Governance requires adherence to the applicable laws and regulations through adequate disclosures, transparency and reliable financial reporting. The law abiding entity improves the image among stakeholders, improved relations with regulators, and avoid pitfalls. All this may happen only due to perfect internal controls.

COSO has enunciated seventeen principles on internal control. The principles have been recognized world over. While it discusses the responsibility for establishing of the internal control measures in the organization, it also describes what internal control can do and what it cannot do. An internal control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance to management and the board regarding achievement of an entity's objectives. The likelihood of achievement is affected by limitations inherent in all internal control systems. These include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the collusion of two or more people, and management has the ability to override the system.
Another limiting factor is that the design of an internal control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs.

GLOSSARY OF TECHNICAL WORDS

- **Internal Control**: The internal control is a process, effected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance.

- **Internal Check**: Internal check is an arrangement of duties allocated in such a way that the work of one clerk is automatically checked by another while internal audit is an independent review of operations and records undertaken by the staff specially appointed for the purpose.

- **Internal Audit**: Internal audit is a dynamic profession involved in helping organisations achieve their objectives. It is concerned with evaluating and improving the effectiveness of risk management, control and governance processes in an organisation.

- **Vigil Mechanism**: Vigil mechanism shall provide for adequate safeguards against victimization of persons who use such mechanism and also make provision for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases.

LESSON ROUND UP

- The Information Systems Control and Audit Association (ISACA) has defined the Internal Control Systems as, ‘The policies and procedures, practices and organizational structures, designed to provide reasonable assurance that business objectives will be achieved and that undesired events will be prevented or detected and corrected’.

- As per definition given by COSO, the internal control is a process, effected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance.

- Components of Internal Control include internal check and internal audit. Internal check means an arrangement that a transaction is processed by two or more persons and each one is independent and starts with when the predecessor has completed the task. So, it is a self-balancing system which have in-built systems of independent checking of the work done by others. Internal audit may be done by the own staff or by engaging any professional person outside of the organisation. The scope of the internal audit is determined by the management. Internal Auditor is required to submit its report to the management (who is appointing authority).

- COSO’s Internal Control Framework includes enhancements and clarifications that are intended to ease use and application. One of the more significant enhancements is the formalization of fundamental concepts introduced in the original framework as principles. These principles, associated with the five components, provide clarity for the user in designing and implementing systems of internal control and for understanding requirements for effective internal control.

- The COSO Framework sets forth three categories of objectives, which allow organizations to focus on separate aspects of internal control. These are Operations Objectives, Reporting and Objectives Compliance Objectives.

- The Framework sets out five components of internal control and seventeen principles representing the fundamental concepts associated with components. Control Environment (5 principles), Risk Assessment (4 Principles), Control Activities (3 Principles), Information and Communication (3 Principles), Monitoring Activities (2 Principles).

- Everyone in an organization (viz: Management, Board of Directors, Internal Auditor and Other persons) all have the responsibility for internal control.
REFERENCE FOR FURTHER READING

https://en.wikipedia.org/wiki/Internal_control

SELF TEST QUESTIONS

1. Discuss in brief the components and principles of Internal Control.
2. Discuss briefly the efficacy of Internal Control.
3. Discuss in detail about the COSO's Internal Control Framework.
4. Write a note on the roles and responsibilities of Internal Control System.
The objective of this study lesson is to enable the students to understand the concept of Reporting which includes the financial as well as non-financial reporting. This chapter explains the regulatory requirements relating to reporting and also discusses about the SEBI Regulations on LODR, PIT, SAST.
INTRODUCTION

REPORTING

Reporting may mean to provide the information to the stakeholders as per the requirement of the law. Reporting is not the new concept. The companies are reporting through their annual report which is a comprehensive report on a company's activities throughout the preceding year. Annual reports are intended to give shareholders and other interested people information about the company's activities and financial performance. They may be considered as grey literature. The annual reports contain the financial reporting as well as non-financial reporting too.

FINANCIAL REPORTING

Financial reporting is the process of producing statements that disclose an organisation's financial status to management, investors and the government.

Financial reporting serves two primary purposes. First, it helps management to engage in effective decision-making concerning the company's objectives and overall strategies. The data disclosed in the reports can help management discern the strengths and weaknesses of the company, as well as its overall financial health. Second, financial reporting provides vital information about the financial health and activities of the company to its stakeholders including its shareholders, potential investors, consumers, and government regulators. It's a means of ensuring that the company is being run appropriately.

Financial Reporting involves the disclosure of financial information to the various stakeholders about the financial performance and financial position of the organisation over a specified period of time. These stakeholders include – investors, creditors, public, debt providers, governments & government agencies. In case of listed companies the frequency of financial reporting is quarterly & annual.

The main components of financial reporting are:

1. The financial statements – Balance Sheet, Statement of Profit & Loss, Cash flow statement & Statement of changes in stockholder's equity
2. The notes to financial statements
3. Quarterly & Annual reports (in case of listed companies)
4. Prospectus (in case of companies going for IPOs)
5. Management Discussion & Analysis (in case of public companies)

The Institute of Chartered Accounts of India (ICAI) have issued various accounting standards and guidance notes which are applied for the purpose of financial reporting. This ensures uniformity across various diversified industries when they prepare and present their financial statements.

Objectives of Financial Reporting

The following points may be summed up as the objectives and purposes of financial reporting –

1. Providing information to management of an organisation which is used for the purpose of planning, analysis, benchmarking and decision making.
2. Providing information to investors, promoters, debt provider and creditors which is used to enable them to make rational and prudent decisions regarding investment, credit etc.
3. Providing information to shareholders & public at large in case of listed companies about various aspects of an organisation.

4. Providing information about the economic resources of an organisation, claims to those resources (liabilities & owner’s equity) and how these resources and claims have undergone change over a period of time.

5. Providing information as to how an organisation is procuring & using various resources.

6. Providing information to various stakeholders regarding performance management of an organisation as to how diligently & ethically they are discharging their fiduciary duties & responsibilities.

7. Providing information to the statutory auditors which in turn facilitates audit.

8. Enhancing social welfare by looking into the interest of employees, trade union & Government.

**Importance of Financial Reporting**

The importance of financial reporting cannot be over emphasized. It is required by each and every stakeholder for multiple reasons and purposes. The following points highlight the importance of financial reporting –

1. Helps and organisation to comply with various statues and regulatory requirements. The organisations are required to file financial statements to ROC, Government Agencies. In case of listed companies, quarterly as well as annual results are required to be filed to stock exchanges and published.

2. It facilitates statutory audit. The statutory auditors are required to audit the financial statements of an organisation to express their opinion.

3. Financial Reports forms backbone for financial planning, analysis, benchmarking and decision making. These are used for above purposes by various stakeholders.

4. Financial reporting helps organisations to raise capital both domestic as well as overseas.

5. On the basis of financials, the public in large can analyze the performance of the organisation as well as of its management.

6. For the purpose of bidding, labour contract, government supplies etc., organisations are required to furnish their financial reports & statements.

**Changing dimensions of Corporate Reporting**

Corporate reporting is an essential means by which companies communicate with investors as part of their accountability and stewardship obligations. The current financial reporting model was developed in the 1930s for an industrial world. In general, the model provides a backwards-looking review of performance and does not provide enough relevant information for decision-making today.

The current reporting model is like “looking in the rear-view mirror,” when in fact the road ahead is very turbulent and there are huge impacts on the company, both societal and environmental.

It is not necessarily the volume of information, but the lack of a comprehensive story, which is where improvements in corporate reporting are needed.
Investors expect information about:

- Business model and strategy,
- Intangible factors and sustainability (i.e. economic, environmental, social) commitments,
- Impacts and performance that affect a company’s value today and its ability to create value in the future,
- Key aspects of corporate governance,
- Internal controls,
- Human rights / diversity practices and policies.

**INTEGRATED REPORTING**

Integrated reporting is a concept that has been created to better articulate the broader range of measures that contribute to long-term value and the role, organisations play in society. Central to this is the proposition that value is increasingly shaped by factors additional to financial performance, such as reliance on the environment, social reputation, human capital skills and others. This value creation concept is the backbone of integrated reporting.

In addition to financial capital, integrated reporting examines five additional capitals that should guide an organisation’s decision-making and long-term success — its value creation in the broadest sense. While integrated reports benefit a broad range of stakeholders, they’re principally aimed at long-term investors. Integrated reporting starts from the position that any value created as a result of a sustainable strategy — regardless of whether it becomes a tangible or intangible asset — will translate, at least partially, into performance. Market value will therefore be impacted.

Sustainable organisations create value by combining a broad range of resources controlled by the organisation or third parties. They are increasingly expected to generate positive outcomes for society that go beyond returns for their shareholders or investors — outcomes that can be instrumental in improving an organisation’s long-term financial performance. Understanding this co-creation and shared value process is fundamental to integrated reporting. Other considerations include:

- An organisation’s value creation potential depends on its ability to identify all of the resources available to it, whether tangible or intangible, owned by the organisation or third parties, and to align them with its corporate strategy
- Any value created, including that which benefits society as a whole, has the potential to impact on the organisation’s value and profitability
- An organisation that communicates its strategy to the market and quantifies this broader contribution may well be stimulating value creation in itself. However, to increase stakeholder confidence the information must be credible.

The International Integrated Reporting Council (IIRC) defines integrated reporting as “a process that results in communication by an organisation, most visibly a periodic integrated report, about how an organisation’s strategy, governance, performance, and prospects lead to the creation of value over the short, medium and long-term.” It promotes a more cohesive and efficient approach to corporate reporting and aims to improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital.
An Integrated Report is “a concise communication about how an organisation’s strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term”. The primary purpose of an integrated report is to explain to providers of financial capital how an organisation creates value over time.

Conceptually, integrated reporting would build on the existing financial reporting model to present additional information about a company’s strategy, governance, and performance. It is aimed at providing a complete picture of a company, including how it demonstrates stewardship and how it creates and sustains value.

The primary purpose of an integrated report is to explain to providers of financial capital how an organisation creates value over time. An integrated report benefits all stakeholders interested in an organisation’s ability to create value over time, including employees, customers, suppliers, business partners, local communities, legislators, regulators and policy-makers.

**Fundamental Concepts of Integrated Reporting**

An integrated report aims to provide insight about the resources and relationships used and affected by an organisation – these are collectively referred to as “the capitals” in this Framework.

It also seeks to explain how the organisation interacts with the external environment and the capitals to create value over the short, medium and long term. The capitals are stocks of value that are increased, decreased or transformed through the activities and outputs of the organisation. They are categorized in this Framework as financial, manufactured, intellectual, human, social and relationship, and natural capital, although organisations preparing an integrated report are not required to adopt this categorization or to structure their report along the lines of the capitals.

The ability of an organisation to create value for itself enables financial returns to the providers of financial capital. This is interrelated with the value the organization creates for stakeholders and society at large through a wide range of activities, interactions and relationships. When these are material to the organisation’s ability to create value for itself, they are included in the integrated report.

**International Integrated Reporting Framework**

The following Guiding Principles underpin the preparation and presentation of an integrated report, informing the content of the report and how information is presented:

- Strategic focus and future orientation
- Connectivity of information
- Stakeholder relationships
- Materiality
- Conciseness
- Reliability and completeness
- Consistency and comparability.

These Guiding Principles are applied individually and collectively for the purpose of preparing and presenting an integrated report; accordingly, judgement is needed in applying them, particularly when there is an apparent tension between them (e.g., between conciseness and completeness).

A. Strategic focus and future orientation: An integrated report should provide insight into the
organisation’s strategy, and how it relates to the organisation’s ability to create value in the short, medium and long term and to its use of and effects on the capitals.

B. Connectivity of information: An integrated report should show a holistic picture of the combination, interrelatedness and dependencies between the factors that affect the organisation’s ability to create value over time.

C. Stakeholder relationships: An integrated report should provide insight into the nature and quality of the organisation’s relationships with its key stakeholders, including how and to what extent the organisation understands, takes into account and responds to their legitimate needs and interests.

D. Materiality: An integrated report should disclose information about matters that substantively affect the organisation’s ability to create value over the short, medium and long term.

E. An integrated report should be concise: An integrated report includes sufficient context to understand the organisation’s strategy, governance, performance and prospects without being burdened with less relevant information.

F. Reliability and completeness: An integrated report should include all material matters, both positive and negative, in a balanced way and without material error.

G. Consistency and comparability: The information in an integrated report should be presented:
   - On a basis that is consistent over time
   - In a way that enables comparison with other organisations to the extent it is material to the organisation’s own ability to create value over time.

An integrated report should include eight Content Elements that are fundamentally linked to each other and are not mutually exclusive:

1. Organisational overview and external environment
2. Governance
3. Business model
4. Risks and opportunities
5. Strategy and resource allocation
6. Performance
7. Outlook
8. Basis of presentation

**Integrated Reporting by Listed Entities in India**

The SEBI has mandated the requirement of submission of Business Responsibility Report (‘BRR’) for top 500 listed entities under Regulation 34(2)(f) of SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 (“SEBI LODR”).

**NON-FINANCIAL REPORTING**

Apart from financial reporting, the non-financial reporting under the annual reports are also being made by the companies. It contains the information relating to the company’s performance during the previous year, future projections, award achievements and penalty imposed, if any by any regulators, are apprised to the
stakeholders by way of reporting in the annual report. Corporate sustainability reporting is one such area of non-financial reporting.

It is a structured way of presenting information about one's performance. If the information is financial in nature, such as financial position, profits, cash flows of an enterprise then it constitutes financial reporting which is beneficial to a wide range of users e.g., stakeholders, investors, regulators, etc. This then brings us to Non-Financial (NFR) or Sustainability Reporting (SR) which, as you are aware, is the practice of measuring, disclosing, and being accountable to internal and external stakeholders for organisational performance towards the goal of sustainable and inclusive development.

There has been a general perception that right from the time of Industrial Revolution, economic development has come at the cost of environment and has brought about large scale destruction of nature and growth process has not been inclusive. Due to the negative externalities of economic development, the practice of non-financial reporting started largely in response to pressure from non-governmental organisations (NGOs) and civic society, which claimed that many firms lacked social and environmental responsibility. It epitomises that a company's financial health is dependent on much more than the assets on its balance sheet and the movements on its profit and loss account. Non-financial reporting is an opportunity to communicate in an open and transparent way with stakeholders. In their non-financial reports, firms volunteer an overview of their environmental and social impact during the previous year. The information in nonfinancial reports contributes to building up a company's risk-return profile.

CORPORATE SUSTAINABILITY REPORTING

Corporate sustainability is an approach that creates long-term stakeholder value by implementing a business strategy that considers every dimension of how a business operates in the ethical, social, environmental, cultural, and economic spheres.

A sustainability report is an organizational report that gives information about economic, environmental, social and governance performance. Sustainability reporting aims to communicate an organization's sustainability priorities, policies, programs, and performance to its investors. Sustainability reporting requires companies to gather information about processes and impacts using Global Reporting Initiative (GRI) Sustainability Reporting Framework.

REPORTING UNDER SEBI (LODR) REGULATIONS, 2015

Principles governing disclosures and obligations (Regulation 4): While reporting disclosures the listed entity shall follow the following principles.

(1) The listed entity which has listed securities shall make disclosures and abide by its obligations under these regulations, in accordance with the following principles:

<table>
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<tr>
<th>(a)</th>
<th>Information shall be prepared and disclosed in accordance with applicable standards of accounting and financial disclosure.</th>
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<td>(b)</td>
<td>The listed entity shall implement the prescribed accounting standards in letter and spirit in the preparation of financial statements taking into consideration the interest of all stakeholders and shall also ensure that the annual audit is conducted by an independent, competent and qualified auditor.</td>
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</table>

1 Excerpts from the Address by Dr K C Chakrabarty, Deputy Governor of the Reserve Bank of India, at the National Conference on “Non-Financial Reporting and Risk Management for Financial Institutions in India”, jointly organised by GIZ, SIDBI, Global Reporting Initiative (GRI), IIM Bangalore and NextGen, Mumbai, 6 June 2011. [https://www.bis.org/review/r110621e.pdf]
(c) The listed entity shall refrain from misrepresentation and ensure that the information provided to recognised stock exchange(s) and investors is not misleading.

(d) The listed entity shall provide adequate and timely information to recognised stock exchange(s) and investors.

(e) The listed entity shall ensure that disseminations made under provisions of these regulations and circulars made thereunder, are adequate, accurate, explicit, timely and presented in a simple language.

(f) Channels for disseminating information shall provide for equal, timely and cost efficient access to relevant information by investors.

(g) The listed entity shall abide by all the provisions of the applicable laws including the securities laws and also such other guidelines as may be issued from time to time by the Board and the recognised stock exchange(s) in this regard and as may be applicable.

(h) The listed entity shall make the specified disclosures and follow its obligations in letter and spirit taking into consideration the interest of all stakeholders.

(i) Filings, reports, statements, documents and information which are event based or are filed periodically shall contain relevant information.

(j) Periodic filings, reports, statements, documents and information reports shall contain information that shall enable investors to track the performance of a listed entity over regular intervals of time and shall provide sufficient information to enable investors to assess the current status of a listed entity.

(2) The listed entity which has listed its specified securities shall comply with the corporate governance provisions as specified in chapter IV which shall be implemented in a manner so as to achieve the objectives of the principles as mentioned below.

(a) **The rights of shareholders:** The listed entity shall seek to protect and facilitate the exercise of the following rights of shareholders:

   (i) Right to participate in, and to be sufficiently informed of, decisions concerning fundamental corporate changes.

   (ii) Opportunity to participate effectively and vote in general shareholder meetings.

   (iii) Being informed of the rules, including voting procedures that govern general shareholder meetings.

   (iv) Opportunity to ask questions to the board of directors, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.

   (v) Effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of board of directors.

   (vi) Exercise of ownership rights by all shareholders, including institutional investors.

   (vii) Adequate mechanism to address the grievances of the shareholders.

   (viii) Protection of minority shareholders from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and effective means of redress.
(b) **Timely information:** The listed entity shall provide adequate and timely information to shareholders, including but not limited to the following:

(i) Sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be discussed at the meeting.

(ii) Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership.

(iii) Rights attached to all series and classes of shares, which shall be disclosed to investors before they acquire shares.

(c) **Equitable treatment:** The listed entity shall ensure equitable treatment of all shareholders, including minority and foreign shareholders, in the following manner:

(i) All shareholders of the same series of a class shall be treated equally.

(ii) Effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of board of directors, shall be facilitated.

(iii) Exercise of voting rights by foreign shareholders shall be facilitated.

(iv) The listed entity shall devise a framework to avoid insider trading and abusive self-dealing.

(v) Processes and procedures for general shareholder meetings shall allow for equitable treatment of all shareholders.

(vi) Procedures of listed entity shall not make it unduly difficult or expensive to cast votes.

(d) **Role of stakeholders in corporate governance:** The listed entity shall recognise the rights of its stakeholders and encourage co-operation between listed entity and the stakeholders, in the following manner:

(i) The listed entity shall respect the rights of stakeholders that are established by law or through mutual agreements.

(ii) Stakeholders shall have the opportunity to obtain effective redress for violation of their rights.

(iii) Stakeholders shall have access to relevant, sufficient and reliable information on a timely and regular basis to enable them to participate in corporate governance process.

(iv) The listed entity shall devise an effective whistle blower mechanism enabling stakeholders, including individual employees and their representative bodies, to freely communicate their concerns about illegal or unethical practices.

(e) **Disclosure and transparency:** The listed entity shall ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the listed entity, in the following manner:

(i) Information shall be prepared and disclosed in accordance with the prescribed standards of accounting, financial and non-financial disclosure.

(ii) Channels for disseminating information shall provide for equal, timely and cost efficient access to relevant information by users.

(iii) Minutes of the meeting shall be maintained explicitly recording dissenting opinions, if any.
(f) **Responsibilities of the board of directors:** The board of directors of the listed entity shall have the following responsibilities:

(i) Disclosure of information:

(1) Members of board of directors and key managerial personnel shall disclose to the board of directors whether they, directly, indirectly, or on behalf of third parties, have a material interest in any transaction or matter directly affecting the listed entity.

(2) The board of directors and senior management shall conduct themselves so as to meet the expectations of operational transparency to stakeholders while at the same time maintaining confidentiality of information in order to foster a culture of good decision-making.

The SEBI (LODR) Regulations provides the following disclosures to be made:

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**Prior Intimations (Regulation 29)**

(1) The listed entity shall give prior intimation to stock exchange about the meeting of the board of directors in which any of the following proposals is due to be considered:

(a) financial results viz. quarterly, half yearly, or annual, as the case may be;

(b) proposal for buyback of securities;

(c) proposal for voluntary delisting by the listed entity from the stock exchange(s);

(d) fund raising by way of further public offer, rights issue, American Depository Receipts/Global Depository Receipts/Foreign Currency Convertible Bonds, qualified institutions placement, debt issue, preferential issue or any other method and for determination of issue price:

**Provided** that intimation shall also be given in case of any annual general meeting or extraordinary general meeting or postal ballot that is proposed to be held for obtaining shareholder approval for further fund raising indicating type of issuance.
(e) declaration/recommendation of dividend, issue of convertible securities including convertible debentures or of debentures carrying a right to subscribe to equity shares or the passing over of dividend.

(f) the proposal for declaration of bonus securities where such proposal is communicated to the board of directors of the listed entity as part of the agenda papers.

(2) The intimation required under sub-regulation (1), shall be given at least two working days in advance, excluding the date of the intimation and date of the meeting:

Provided that intimation regarding item specified in clause (a) of sub-regulation (1), to be discussed at the meeting of board of directors shall be given at least five days in advance (excluding the date of the intimation and date of the meeting), and such intimation shall include the date of such meeting of board of directors.

(3) The listed entity shall give intimation to the stock exchange(s) at least eleven working days before any of the following proposal is placed before the board of directors —

(a) any alteration in the form or nature of any of its securities that are listed on the stock exchange or in the rights or privileges of the holders thereof.

(b) any alteration in the date on which, the interest on debentures or bonds, or the redemption amount of redeemable shares or of debentures or bonds, shall be payable.

Disclosure of events or information (Regulation 30)

(1) Every listed entity shall make disclosures of any events or information which, in the opinion of the board of directors of the listed company, is material.

(2) Events specified in Para A of Part A of Schedule III are deemed to be material events and listed entity shall make disclosure of such events.

(3) The listed entity shall make disclosure of events specified in Para B of Part A of Schedule III, based on application of the guidelines for materiality, as specified in sub-regulation (4).

(4) (i) The listed entity shall consider the following criteria for determination of materiality of events/information:

   (a) the omission of an event or information, which is likely to result in discontinuity or alteration of event or information already available publicly; or

   (b) the omission of an event or information is likely to result in significant market reaction if the said omission came to light at a later date;

   (c) In case where the criteria specified in sub-clauses (a) and (b) are not applicable, an event/information may be treated as being material if in the opinion of the board of directors of listed entity, the event/information is considered material.

   (ii) The listed entity shall frame a policy for determination of materiality, based on criteria specified in this sub-regulation, duly approved by its board of directors, which shall be disclosed on its website.

(5) The board of directors of the listed entity shall authorize one or more Key Managerial Personnel for the purpose of determining materiality of an event or information and for the purpose of making disclosures to stock exchange(s) under this regulation and the contact details of such personnel shall be also disclosed to the stock exchange(s) and as well as on the listed entity's website.
(6) The listed entity shall first disclose to stock exchange(s) of all events, as specified in Part A of Schedule III, or information as soon as reasonably possible and not later than twenty four hours from the occurrence of event or information:

Provided that in case the disclosure is made after twenty four hours of occurrence of the event or information, the listed entity shall, along with such disclosures provide explanation for delay:

Provided further that disclosure with respect to events specified in sub-para 4 of Para A of Part A of Schedule III shall be made within thirty minutes of the conclusion of the board meeting.

(7) The listed entity shall, with respect to disclosures referred to in this regulation, make disclosures updating material developments on a regular basis, till such time the event is resolved/closed, with relevant explanations.

(8) The listed entity shall disclose on its website all such events or information which has been disclosed to stock exchange(s) under this regulation, and such disclosures shall be hosted on the website of the listed entity for a minimum period of five years and thereafter as per the archival policy of the listed entity, as disclosed on its website.

(9) The listed entity shall disclose all events or information with respect to subsidiaries which are material for the listed entity.

(10) The listed entity shall provide specific and adequate reply to all queries raised by stock exchange(s) with respect to any events or information:

Provided that the stock exchange(s) shall disseminate information and clarification as soon as reasonably practicable.

(11) The listed entity may on its own initiative also, confirm or deny any reported event or information to stock exchange(s).

(12) In case where an event occurs or an information is available with the listed entity, which has not been indicated in Para A or B of Part A of Schedule III, but which may have material effect on it, the listed entity is required to make adequate disclosures in regard thereof.

**Holding of specified securities and shareholding pattern (Regulation 31)**

(1) The listed entity shall submit to the stock exchange(s) a statement showing holding of securities and shareholding pattern separately for each class of securities, in the format specified by the Board from time to time within the following timelines -

(a) one day prior to listing of its securities on the stock exchange(s);

(b) on a quarterly basis, within twenty one days from the end of each quarter; and,

(c) within ten days of any capital restructuring of the listed entity resulting in a change exceeding two per cent of the total paid-up share capital:

Provided that in case of listed entities which have listed their specified securities on SME Exchange, the above statements shall be submitted on a half yearly basis within twenty one days from the end of each half year.

(2) The listed entity shall ensure that hundred percent of shareholding of promoter(s) and promoter group is in dematerialized form and the same is maintained on a continuous basis in the manner as specified by the Board.

(3) The listed entity shall comply with circulars or directions issued by the Board from time to time with respect to maintenance of shareholding in dematerialized form.
Disclosure of Class of shareholders and Conditions for Reclassification ([Regulation 31A])

(1) All entities falling under promoter and promoter group shall be disclosed separately in the shareholding pattern appearing on the website of all stock exchanges having nationwide trading terminals where the specified securities of the entity are listed, in accordance with the formats specified by SEBI.

(2) The stock exchange, specified in sub-regulation (1), shall allow modification or reclassification of the status of the shareholders, only upon receipt of a request from the concerned listed entity or the concerned shareholders along with all relevant evidence and on being satisfied with the compliance of conditions mentioned in this regulation.

(3) In case of entities listed on more than one stock exchange, the concerned stock exchanges shall jointly decide on the application of the entity/ shareholders, as specified in sub-regulation(2).

(4) In case of transmission/succession/inheritance, the inheritor shall be classified as promoter.

(5) When a new promoter replaces the previous promoter subsequent to an open offer or in any other manner, re-classification may be permitted subject to approval of shareholders in the general meeting and compliance of the following conditions:

(a) Such promoter along with the promoter group and the Persons Acting in Concert shall not hold more than ten per cent of the paid-up equity capital of the entity.

(b) Such promoter shall not continue to have any special rights through formal or informal arrangements. All shareholding agreements granting special rights to such entities shall be terminated.

(c) Such promoters and their relatives shall not act as key managerial person for a period of more than three years from the date of shareholders’ approval: Provided that the resolution of the said shareholders’ meeting must specifically grant approval for such promoter to act as key managerial person.

(6) Where an entity becomes professionally managed and does not have any identifiable promoter the existing promoters may be re-classified as public shareholders subject to approval of the shareholders in a general meeting.

Explanation.- For the purposes of this sub-regulation an entity may be considered as professionally managed, if-

(i) No person or group along with persons acting in concert taken together shall hold more than one per cent paid-up equity capital of the entity including any holding of convertibles/outstanding warrants/ Depository Receipts:

Provided that any mutual fund, bank, insurance company, financial institution, foreign portfolio investor may individually hold up to ten per cent paid-up equity capital of the entity including any holding of convertibles/outstanding warrants/ Depository Receipts.

(ii) The promoters seeking reclassification and their relatives may act as key managerial personnel in the entity only subject to shareholders’ approval and for a period not exceeding three years from the date of shareholders’ approval.

(iii) The promoter seeking reclassification along with his promoter group entities and the persons acting in concert shall not have any special right through formal or informal arrangements. All shareholding agreements granting special rights to such outgoing entities shall be terminated.
(7) Without prejudice to sub-regulations (5) and (6), re-classification of promoter as public shareholders shall be subject to the following conditions:

(a) Such promoter shall not, directly or indirectly, exercise control, over the affairs of the entity.

(b) Increase in the level of public shareholding pursuant to re-classification of promoter shall not be counted towards achieving compliance with minimum public shareholding requirement under rule 19A of the Securities Contracts (Regulation) Rules, 1957, and the provisions of these regulations.

(c) The event of re-classification shall be disclosed to the stock exchanges as a material event in accordance with the provisions of these regulations.

(d) Board may relax any condition for re-classification in specific cases, if it is satisfied about non-exercise of control by the outgoing promoter or its persons acting in concert.

(8) If any public shareholder seeks to re-classify itself as promoter, it shall be required to make an open offer in accordance with the provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

(9) The provisions of sub-regulations (5), (6) and clause (b) of sub-regulation (7) of this regulation shall not apply, if re-classification of existing promoter or promoter group of the listed entity is as per the resolution plan approved under section 31 of the Insolvency Code, subject to the following conditions:

(i) the existing promoter and promoter group seeking re-classification shall not remain in control of the listed entity; and

(ii) such re-classification along with the underlying rationale shall be disclosed to the stock exchanges within one day of the resolution plan being approved.

Statement of deviation(s) or variation(s) (Regulation 32)

(1) The listed entity shall submit to the stock exchange the following statement(s) on a quarterly basis for public issue, rights issue, preferential issue etc., -

(a) indicating deviations, if any, in the use of proceeds from the objects stated in the offer document or explanatory statement to the notice for the general meeting, as applicable;

(b) indicating category wise variation (capital expenditure, sales and marketing, working capital etc.) between projected utilisation of funds made by it in its offer document or explanatory statement to the notice for the general meeting, as applicable and the actual utilisation of funds.

(2) The statement(s) specified in sub-regulation (1), shall be continued to be given till such time the issue proceeds have been fully utilised or the purpose for which these proceeds were raised has been achieved.

(3) The statement(s) specified in sub-regulation (1), shall be placed before the audit committee for review and after such review, shall be submitted to the stock exchange(s).

(4) The listed entity shall furnish an explanation for the variation specified in sub-regulation (1), in the directors’ report in the annual report.

2 Sub-regulation (9) inserted by the SEBI (Listing Obligations and Disclosure Requirements) (Third Amendment) Regulations, 2018, w.e.f. 31-5-2018.
(5) The listed entity shall prepare an annual statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice, certified by the statutory auditors of the listed entity, and place it before the audit committee till such time the full money raised through the issue has been fully utilized.

(6) Where the listed entity has appointed a monitoring agency to monitor utilisation of proceeds of a public or rights issue, the listed entity shall submit to the stock exchange(s) any comments or report received from the monitoring agency.

(7) Where the listed entity has appointed a monitoring agency to monitor the utilisation of proceeds of a public or rights issue, the monitoring report of such agency shall be placed before the audit committee on an annual basis, promptly upon its receipt.

Explanation.—For the purpose of this sub-regulation, “monitoring agency” shall mean the monitoring agency specified in regulation 16 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

(7A) Where an entity has raised funds through preferential allotment or qualified institutions placement, the listed entity shall disclose every year, the utilization of such funds during that year in its Annual Report until such funds are fully utilized.

(8) For the purpose of this regulation, any reference to “quarterly/quarter” in case of listed entity which have listed their specified securities on SME Exchange shall respectively be read as “half yearly/half year”.

**Annual Report (Regulation 34)**

1. The listed entity shall submit to the stock exchange and publish on its website-

   (a) a copy of the annual report sent to the shareholders along with the notice of the annual general meeting not later than the day of commencement of dispatch to its shareholders;

   (b) in the event of any changes to the annual report, the revised copy along with the details of and explanation for the changes shall be sent not later than 48 hours after the annual general meeting."

Regulation 34(1) shall be applicable in respect of the Annual report filed for the year ended March 31, 2019 and thereafter.

2. The annual report shall contain the following:

   (a) audited financial statements i.e. balance sheets, profit and loss accounts etc [and Statement on Impact of Audit Qualifications as stipulated in regulation 33(3)(d), if applicable;]

   (b) consolidated financial statements audited by its statutory auditors;

   (c) cash flow statement presented only under the indirect method as prescribed in Accounting Standard-3 or Indian Accounting Standard 7, as applicable, specified in Section 133 of the Companies Act, 2013 read with relevant rules framed thereunder or as specified by the Institute of Chartered Accountants of India, whichever is applicable; directors report; management discussion and analysis report - either as a part of directors report or addition thereto;

   (f) for the top [five hundred] listed entities based on market capitalization (calculated as on March 31 of every financial year), business responsibility report describing the initiatives taken by them.
from an environmental, social and governance perspective, in the format as specified by the Board from time to time: Provided that listed entities other than top [five hundred] listed companies based on market capitalization and listed entities which have listed their specified securities on SME Exchange, may include these business responsibility reports on a voluntary basis in the format as specified in SEBI Circular CIR/CFD/CMD/10/2015 dated 4 November 2015.

(3) The annual report shall contain any other disclosures specified in Companies Act, 2013 along with other requirements as specified in Schedule V of these regulations.

**Annual Information Memorandum (Regulation 35)**

The listed entity shall submit to the stock exchange(s) an Annual Information Memorandum in the manner specified by the Board from time to time.

**Website (Regulation 46)**

(1) The listed entity shall maintain a functional website containing the basic information about the listed entity.

(2) The listed entity shall disseminate the following information 4[under a separate section on its website]:

(a) details of its business;
(b) terms and conditions of appointment of independent directors;
(c) composition of various committees of board of directors;
(d) code of conduct of board of directors and senior management personnel;
(e) details of establishment of vigil mechanism/Whistle Blower policy;
(f) criteria of making payments to non-executive directors, if the same has not been disclosed in annual report;
(g) policy on dealing with related party transactions;
(h) policy for determining 'material' subsidiaries;
(i) details of familiarization programmes imparted to independent directors including the following details:—
   (i) number of programmes attended by independent directors (during the year and on a cumulative basis till date),
   (ii) number of hours spent by independent directors in such programmes (during the year and on cumulative basis till date), and
   (iii) other relevant details
(j) the email address for grievance redressal and other relevant details;
(k) contact information of the designated officials of the listed entity who are responsible for assisting and handling investor grievances;

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4 Substituted for “on its website” by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. 1-4-2019.
(l) financial information including:

(i) notice of meeting of the board of directors where financial results shall be discussed;
(ii) financial results, on conclusion of the meeting of the board of directors where the financial results were approved;
(iii) complete copy of the annual report including balance sheet, profit and loss account, directors report, corporate governance report etc.;
(m) shareholding pattern;
(n) details of agreements entered into with the media companies and/or their associates, etc.;
(o) schedule of analyst or institutional investor meet and presentations made by the listed entity to analysts or institutional investors simultaneously with submission to stock exchange;
(p) new name and the old name of the listed entity for a continuous period of one year, from the date of the last name change;
(q) items in sub-regulation (1) of regulation 47;
(r) with effect from October 1, 2018, all credit ratings obtained by the entity for all its outstanding instruments, updated immediately as and when there is any revision in any of the ratings;
(s) separate audited financial statements of each subsidiary of the listed entity in respect of a relevant financial year, uploaded at least 21 days prior to the date of the annual general meeting which has been called to inter alia consider accounts of that financial year.

(3) (a) The listed entity shall ensure that the contents of the website are correct.

(b) The listed entity shall update any change in the content of its website within two working days from the date of such change in content.

**Intimation to stock exchange(s) (Regulation 50)**

(1) The listed entity shall give prior intimation to the stock exchange(s) at least eleven working days before the date on and from which the interest on debentures and bonds, and redemption amount of redeemable shares or of debentures and bonds shall be payable.

(2) The listed entity shall intimate the stock exchange(s), its intention to raise funds through new non-convertible debt securities or non-convertible redeemable preference shares it proposes to list either through a public issue or on private placement basis, prior to issuance of such securities:

Provided that the above intimation may be given prior to the meeting of board of directors wherein the proposal to raise funds through new non convertible debt securities or non-convertible redeemable preference shares shall be considered.

(3) The listed entity shall intimate to the stock exchange(s), at least two working days in advance, excluding the date of the intimation and date of the meeting, regarding the meeting of its board of directors, at which the recommendation or declaration of issue of non convertible debt securities or any other matter affecting the rights or interests of holders of non convertible debt securities or non convertible redeemable preference shares is proposed to be considered.

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5 Inserted by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. 1-4-2019.
Disclosure of information having bearing on performance/operation of listed entity and/or price sensitive information (Regulation 51)

(1) The listed entity shall promptly inform the stock exchange(s) of all information having bearing on the performance/operation of the listed entity, price sensitive information or any action that shall affect payment of interest or dividend of non-convertible preference shares or redemption of non-convertible debt securities or redeemable preference shares.

Explanation:- The expression 'promptly inform', shall imply that the stock exchange must be informed as soon as practically possible and without any delay and that the information shall be given first to the stock exchange(s) before providing the same to any third party.

(2) Without prejudice to the generality of sub-regulation(1), the listed entity who has issued or is issuing non-convertible debt securities and/or non-convertible redeemable preference shares shall make disclosures as specified in Part B of Schedule III.

Annual Report (Regulation 53)

The annual report of the listed entity shall contain disclosures as specified in Companies Act, 2013 along with the following:

(a) audited financial statements i.e. balance sheets, profit and loss accounts etc 6[, and Statement on Impact of Audit Qualifications as stipulated in regulation 52(3)(a), if applicable.]

(b) cash flow statement presented only under the indirect method as prescribed in Accounting Standard-3/ Indian Accounting Standard 7, mandated under Section 133 of the Companies Act, 2013 read with relevant rules framed thereunder or by the Institute of Chartered Accountants of India, whichever is applicable;

(c) auditors report;

(d) directors report;

(e) name of the debenture trustees with full contact details;

(f) related party disclosures as specified in Para A of Schedule V.

Other submissions to stock exchange(s) (Regulation 57)

(1) The listed entity shall submit a certificate to the stock exchange within two days of the interest or principal or both becoming due that it has made timely payment of interests or principal obligations or both in respect of the non-convertible debt securities.

(2) The listed entity shall provide an undertaking to the stock exchange(s) on annual basis stating that all documents and intimations required to be submitted to Debenture Trustees in terms of Trust Deed and Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008 have been complied with.

(3) The listed entity shall forward to the stock exchange any other information in the manner and format as specified by the Board from time to time.

REPORTING UNDER SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015 (PIT)

The SEBI (Prohibition of Insider Trading) Regulations, 2015, vide NOTIFICATION NO. LAD-NRO/GN/2014-

6 Substituted for “,” by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2016, w.r.e.f. 1-4-2016.
15/21/85, DATED 15th January, 2015, put in place a framework for prohibition of insider trading in securities and to strengthen the legal framework thereof.

**Who is Compliance Officer:** The Regulation 2(c) defines the meaning of “compliance officer”. It means any senior officer, designated so and reporting to the board of directors or head of the organisation in case board is not there, who is financially literate and is capable of appreciating requirements for legal and regulatory compliance under these regulations and who shall be responsible for compliance of policies, procedures, maintenance of records, monitoring adherence to the rules for the preservation of unpublished price sensitive information, monitoring of trades and the implementation of the codes specified in these regulations under the overall supervision of the board of directors of the listed company or the head of an organisation, as the case may be.

**Who is connected person:** Regulation 2(d) defines the meaning of connected person. It means:

i. any person who is or has during the six months prior to the concerned act been associated with a company, directly or indirectly, in any capacity including by reason of frequent communication with its officers or by being in any contractual, fiduciary or employment relationship or by being a director, officer or an employee of the company or holds any position including a professional or business relationship between himself and the company whether temporary or permanent, that allows such person, directly or indirectly, access to unpublished price sensitive information or is reasonably expected to allow such access.

ii. Without prejudice to the generality of the foregoing, the persons falling within the following categories shall be deemed to be connected persons unless the contrary is established,—

a. an immediate relative of connected persons specified in clause (i); or

b. a holding company or associate company or subsidiary company; or

c. an intermediary as specified in section 12 of the Act or an employee or director thereof; or

d. an investment company, trustee company, asset management company or an employee or director thereof; or

e. an official of a stock exchange or of clearing house or corporation; or

f. a member of board of trustees of a mutual fund or a member of the board of directors of the asset management company of a mutual fund or is an employee thereof; or

g. a member of the board of directors or an employee, of a public financial institution as defined in section 2 (72) of the Companies Act, 2013; or

h. an official or an employee of a self-regulatory organisation recognised or authorized by the Board; or

i. a banker of the company; or

j. a concern, firm, trust, Hindu undivided family, company or association of persons wherein a director of a company or his immediate relative or banker of the company, has more than ten per cent. of the holding or interest;

**CODE OF FAIR DISCLOSURE**

Regulation 8 deals with the formulation of the Code of Practices and Procedures by the Board of Director: Its Sub-Regulation (1) provides that the Board of Directors of every company, whose securities are listed on a stock exchange, shall formulate and publish on its official website, a code of practices and
procedures for fair disclosure of unpublished price sensitive information that it would follow in order to adhere to each of the principles set out in Schedule A to these regulations, without diluting the provisions of these regulations in any manner.

Sub-Regulation (2) provides that every such code of practices and procedures for fair disclosure of unpublished price sensitive information and every amendment thereto shall be promptly intimated to the stock exchanges where the securities are listed.

**Code of Conduct**

**Board of Directors to formulate Code of Conduct:** Regulation 9 deals with the Code of Conduct. Sub-Regulation (1) provides that the board of directors of every listed company and market intermediary shall formulate a code of conduct to regulate, monitor and report trading by its employees and other connected persons towards achieving compliance with these regulations, adopting the minimum standards set out in Schedule B to these regulations, without diluting the provisions of these regulations in any manner.

Person handling unpublished price sensitive information to formulate Code of Conduct: Sub-Regulation (2) provides that every other person who is required to handle unpublished price sensitive information in the course of business operations shall formulate a code of conduct to regulate, monitor and report trading by employees and other connected persons towards achieving compliance with these regulations, adopting the minimum standards set out in Schedule B to these regulations, without diluting the provisions of these regulations in any manner.

**Minimum Standards for Code of Conduct to Regulate, Monitor and Report Trading by Insiders:**

Schedule B of the said Regulation provides the minimum standards for Code of Conduct to Regulated, Monitor and Report Trading by Insiders.

1. **Reporting by the Compliance Officer:** The compliance officer shall report to the board of directors and in particular, shall provide reports to the Chairman of the Audit Committee, if any, or to the Chairman of the board of directors at such frequency as may be stipulated by the board of directors.

2. **Information on need to know basis:** All information shall be handled within the organisation on a need-to-know basis and no unpublished price sensitive information shall be communicated to any person except in furtherance of the insider's legitimate purposes, performance of duties or discharge of his legal obligations. The code of conduct shall contain norms for appropriate Chinese Walls procedures, and processes for permitting any designated person to "cross the wall".

3. **Internal Code of Conduct for the Designated Persons:** Employees and connected persons designated on the basis of their functional role (designated persons) in the organisation shall be governed by an internal code of conduct governing dealing in securities. The board of directors shall in consultation with the compliance officer specify the designated persons to be covered by such code on the basis of their role and function in the organisation. Due regard shall be had to the access that such role and function would provide to unpublished price sensitive information in addition to seniority and professional designation.

4. **Closure of Trading Window:** Designated persons may execute trades subject to compliance with these regulations. Towards this end, a notional trading window shall be used as an instrument of monitoring trading by the designated persons. The trading window shall be closed when the compliance officer determines that a designated person or class of designated persons can
reasonably be expected to have possession of unpublished price sensitive information. Such
closure shall be imposed in relation to such securities to which such unpublished price sensitive
information relates. Designated persons and their immediate relatives shall not trade in securities
when the trading window is closed.

5. **Re-opening of Trading Window:** The timing for re-opening of the trading window shall be
determined by the compliance officer taking into account various factors including the unpublished
price sensitive information in question becoming generally available and being capable of
assimilation by the market, which in any event shall not be earlier than forty-eight hours after the
information becomes generally available. The trading window shall also be applicable to any person
having contractual or fiduciary relation with the company, such as auditors, accountancy firms, law
firms, analysts, consultants etc., assisting or advising the company.

6. **Pre-clearance by the Compliance Officer:** When the trading window is open, trading by
designated persons shall be subject to pre-clearance by the compliance officer, if the value of the
proposed trades is above such thresholds as the board of directors may stipulate. No designated
person shall apply for pre-clearance of any proposed trade if such designated person is in
possession of unpublished price sensitive information even if the trading window is not closed.

7. **Restricted List:** The compliance officer shall confidentially maintain a list of such securities as a
"restricted list" which shall be used as the basis for approving or rejecting applications for pre-
clearance of trades.

8. **Declarations from persons not having the unpublished price sensitive information:** Prior to
approving any trades, the compliance officer shall be entitled to seek declarations to the effect that
the applicant for pre-clearance is not in possession of any unpublished price sensitive information.
He shall also have regard to whether any such declaration is reasonably capable of being rendered
inaccurate.

9. **Time frame of trading days:** The code of conduct shall specify any reasonable timeframe, which in
any event shall not be more than seven trading days, within which trades that have been pre-
cleared have to be executed by the designated person, failing which fresh pre-clearance would be
needed for the trades to be executed.

10. **Specification of period for not executing contra trade:** The code of conduct shall specify the
period, which in any event shall not be less than six months, within which a designated person who
is permitted to trade shall not execute a contra trade. The compliance officer may be empowered to
grant relaxation from strict application of such restriction for reasons to be recorded in writing
provided that such relaxation does not violate these regulations. Should a contra trade be executed,
inadvertently or otherwise, in violation of such a restriction, the profits from such trade shall be liable
to be disgorged for remittance to the Board for credit to the Investor Protection and Education Fund
administered by the Board under the Act.

11. **Format of application for pre-clearance:** The code of conduct shall stipulate such formats as the
board of directors deems necessary for making applications for pre-clearance, reporting of trades
executed, reporting of decisions not to trade after securing pre-clearance, recording of reasons for
such decisions and for reporting level of holdings in securities at such intervals as may be
determined as being necessary to monitor compliance with these regulations.

12. **Sanctions and disciplinary actions:** Without prejudice to the power of the Board under the Act,
the code of conduct shall stipulate the sanctions and disciplinary actions, including wage freeze,
suspension etc., that may be imposed, by the persons required to formulate a code of conduct
under sub-regulation (1) and sub-regulation (2) of regulation 9, for the contravention of the code of conduct.

13 **Appraisal to the Board of Directors for violation of the Code of Conduct:** The code of conduct shall specify that in case it is observed by the persons required to formulate a code of conduct under sub-regulation (1) and sub-regulation (2) of regulation 9, that there has been a violation of these regulations, they shall inform the Board promptly.

### Reporting under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011

**Who is acquirer:** Acquirer means any person who, directly or indirectly, acquires or agrees to acquire whether by himself, or through, or with persons acting in concert with him, shares or voting rights in, or control over a target company;

**What is acquisition:** It means directly or indirectly, acquiring or agreeing to acquire shares or voting rights in, or control over, a target company.

**What is control:** Control includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner. A director or officer of a target company shall not be considered to be in control over such target company, merely by virtue of holding such position.

### Disclosure of acquisition and disposal (Regulation 29)

1. Any acquirer who acquires shares or voting rights in a target company which taken together with shares or voting rights, if any, held by him and by persons acting in concert with him in such target company, aggregating to five per cent or more of the shares of such target company, shall disclose their aggregate shareholding and voting rights in such target company in such form as may be specified.

2. Any person, who together with persons acting in concert with him, holds shares or voting rights entitling them to five per cent or more of the shares or voting rights in a target company, shall disclose the number of shares or voting rights held and change in shareholding or voting rights, even if such change results in shareholding falling below five per cent, if there has been change in such holdings from the last disclosure made under sub-regulation (1) or under this sub-regulation; and such change exceeds two per cent of total shareholding or voting rights in the target company, in such form as may be specified.

3. The disclosures required under sub-regulation (1) and sub-regulation (2) shall be made within two working days of the receipt of intimation of allotment of shares, or the acquisition of shares or voting rights in the target company to:

   (a) Every stock exchange where the shares of the target company are listed; and

   (b) The target company at its registered office.

4. For the purposes of this regulation, shares taken by way of encumbrance shall be treated as an acquisition, shares given upon release of encumbrance shall be treated as a disposal, and disclosures shall be made by such person accordingly in such form as may be specified:

   Provided that such requirement shall not apply to a scheduled commercial bank or public financial institution as pledgee in connection with a pledge of shares for securing indebtedness in the ordinary course of business.
Continual Disclosure (Regulation 30)

1. Every person, who together with persons acting in concert with him, holds shares or voting rights entitling him to exercise twenty-five per cent or more of the voting rights in a target company, shall disclose their aggregate shareholding and voting rights as of the thirty-first day of March, in such target company in such form as may be specified.

2. The promoter of every target company shall together with persons acting in concert with him, disclose their aggregate shareholding and voting rights as of the thirty-first day of March, in such target company in such form as may be specified.

3. The disclosures required under sub-regulation (1) and sub-regulation (2) shall be made within seven working days from the end of each financial year to:
   (a) every stock exchange where the shares of the target company are listed; and
   (b) the target company at its registered office.

Disclosure of encumbered shares (Regulation 31)

The promoter of every target company shall disclose details of shares in such target company encumbered by him or by persons acting in concert with him in such form as may be specified.

The promoter of every target company shall disclose details of any invocation of such encumbrance or release of such encumbrance of shares in such form as may be specified.

The disclosures required under sub-regulation (1) and sub-regulation (2) shall be made within seven working days from the creation or invocation or release of encumbrance, as the case may be to: (a) every stock exchange where the shares of the target company are listed; and (b) the target company at its registered office.

GLOSSARY OF TECHNICAL WORDS

- **Integrated Reporting**: Integrated reporting (IR) is a "process that results in communication, most visibly a periodic “integrated report”, about value creation over time.

- **Financial Reporting**: Financial reporting is the process of producing statements that disclose an organization's financial status to management, investors and the government.

- **Annual Report**: An annual report is a comprehensive report on a company’s activities throughout the preceding year. Annual reports are intended to give shareholders and other interested people information about the company's activities and financial performance.

- **Encumbered Shares**: Encumbered securities are securities that are owned by one entity, but subject to a legal claim by another. When an entity borrows from another, legal claim on the securities owned by the borrower can be taken as security by the lender should the borrower default on its obligation.

LESSON ROUND UP

- Integrated reporting is a concept that has been created to better articulate the broader range of measures that contribute to long-term value and the role, organisations play in society. The Guiding principles of International Integrated Reporting Framework are: Strategic focus and future orientation, Connectivity of information, Stakeholder relationships, Materiality, Conciseness, Reliability and completeness, Consistency and comparability.
Corporate sustainability is an approach that creates long-term stakeholder value by implementing a business strategy that considers every dimension of how a business operates in the ethical, social, environmental, cultural, and economic spheres.

Principles governing disclosures and obligations are contained in Regulation 4 of the SEBI (LODR) Regulations. The LODR also prescribes regulations relating to Prior Intimations, disclosure of events or information, holding of specified securities and shareholding pattern, disclosure of class of shareholders and conditions for reclassifications, disclosures to be made in the annual report etc.

SEBI (Prohibition of Insider Trading) Regulations defines who may be the compliance officer and prescribes the Code of Fair Disclosure.

SEBI (SAST) Regulations provides that disclosure of acquisition and disposal at the time of substantial acquisition and continuous disclosures.

REFERENCE FOR FURTHER READING


SELF TEST QUESTIONS

1. What is Integrated Reporting?
3. Describe the reporting as prescribed by the SEBI(LODR) Regulations, 2015.
4. Discuss the rules prescribed by the SEBI (Prohibition of Insider Trading) Regulations.
5. Discuss the limitations of financial reporting
6. What is a Sustainability Report?
# Lesson 15
## Ethics and Business

### LESSON OUTLINE
- Introduction
- Ethics
- Business Ethics
- Organisation Structure and Ethics
- Ethical Dilemma
- Code of Ethics
- Indian Ethos
- Code of Conduct
- Advantages of Business Ethics
- Conclusion
- Glossary
- Lesson Round-Up
- Self Test Questions

### LEARNING OBJECTIVES

The objective of this study lesson is to enable the students to understand the importance of Business Ethics and its advantages to the organization.

Promotion of culture of ethics is an imperative, and it is increasingly being realized that it is the bedrock of good governance which ultimately re-instills the confidence of the stakeholder in the company.

The objective of the study lesson is to enable the students understand the following:

- Inner Conscience and its Linkage to Governance
- The concept of business ethics
- Advantages of Ethics
INTRODUCTION

Today, the corporate world as a whole is in the process of acquiring a moral conscience. The new and emerging concepts in management like corporate governance, business ethics and corporate sustainability are some of the expressions through which this emerging ethical instinct in the corporate world is trying to express and embody itself in the corporate life. In this study we examine the concept of ethics and its importance for the business, corporate governance and governance through inner conscience and sustainability.

WHAT IS ETHICS

As per the Oxford Dictionary the meaning of ethics is a “system of moral principles, rules and conduct.”. Ethics is a “Science of morals.” The word ethics has emerged from Latin ‘Ethicus’ or in Greek ‘Ethicos’. The origin of these two words is from ‘ethos’ meaning character. Character unlike behavior is an intrinsic or basic factor which derives from inner most.

The term 'ethics' can commonly refer to the rules and principles that define right and wrong conduct of individuals (Robbins, Bergman, Stagg and Coulter, 2003, p.150). Ethical Behavior is accepted as "right" or "good" in the context of a governing moral code. Ethics can be viewed as a way of behaving that can be prescribed and imposed by the work environment (Garcia-Zamor, 2003).

Ethics refers to well-founded standards of right and wrong that prescribe what humans ought to do, usually in terms of rights, obligations, benefits to society, fairness, or specific virtues.

Thus, ethics relates to the standards of conduct and moral judgements that differentiate right from wrong. Ethics is not a natural science but a creation of the human mind. For this reason, it is not absolute and is open to the influence of time, place and situation.

BUSINESS ETHICS

Business ethics constitute the ethical/moral principles and challenges that arise in a business environment. Some of the areas related with – and not limited to- business ethics include the following:


Business Ethics is the application of ethical principles and methods of analysis to business. Business ethics deals with the topic of study that has been given its due importance in business, commerce and industry since last three decades.

Context and relevance of Business Ethics in today’s business

Present day global crisis has raised questions about the legitimacy of capitalism. Ethical failures certainly played a role. While it remains to be seen whether and how many people blatantly broke the law, there are abundant signs of various forms of potentially unethical behavior. These include greed, unreasonable amounts of leverage, subtle forms of corruption (such as ratings agencies that appear to have had a conflict of interest), complex financial instruments that no one really understood, and herd behavior where people...
just followed along and failed to exercise independent judgment. Business leaders must use their personal moral compasses to make ethical decisions. As for the business’s compass, it should be oriented toward satisfying customers above all stakeholders. That is the orientation that allows for the greatest competitive success and profitability.

The question is what sort of changes will be needed in business management principles and practices to build companies that are truly fit for the future?

Gary Hamel, World's most influential business thinker (The Wall Street) and world's leading expert on business strategy (Fortune), answered this question which is basically conclusions of one International Conference in California organized by The Management Lab - a Silicon Valley based research organization, with the support of McKinsey & Company, where 35 top management scholars and practitioners of the world met for two days to debate the future of management. These are the points:

- “Modern” management much of which dates back to the late nineteenth century has reached the limits of improvement.
- Unless management innovators tackle those issues, companies will be unable to cope with tomorrow's volatile world.
- Management pioneers must find ways to infuse mundane business activities with deeper, soul-stirring ideals, such as honor, truth, love, justice, and beauty. These timeless virtues have long inspired human beings to extraordinary accomplishment and can no longer be relegated to the fringes of management.
- Most companies strive to maximize shareholder wealth - a goal that is inadequate. As an emotional catalyst, wealth maximization lacks the power to fully mobilize human energies.... Tomorrow's management systems must give as much credence to such timeless human ideals as beauty, justice, and community as they do to the traditional goals of efficiency, advantage, and profit.
- Tomorrow's managers will require new skills, among them reflective learning, system-based thinking, creative problem solving, and values-driven thinking. Business Schools and companies must redesign training programs to help executives develop such skills and reorient management systems to encourage their application.

— Ciary Hamel (Director, The Management Lab, a Silicon Valley based research organization) Ref: Harvard and Business Review, February 2009 issue, p.79-86

Mere professional competence alone does not lead to excellence. In the long-term enduring quality or excellence comes from values. These universal human values like truth, beauty, goodness and harmony are applicable to all human activity. But for practical application of these values for a professional activity, we have to take into consideration the unique and intrinsic nature of that activity.

Now the question is How Values affect the bottom line?

Here comes an important principle, which is beginning to be recognized in the modern corporate life. It is the pragmatic significance of values. For a moral or spiritual value lived in action releases a corresponding moral or spiritual force, which in the long-term leads to positive material gains. This is a fact, which was intuitively perceived by all morally and spiritually sensitive minds but difficult to prove in empirical terms. However, there is at present a growing body of research, which indicates that moral ideals can lead to financial and business success.

For example, Patricia Aburdene, in her well-known book, "Megatrends 2010” states:

“Socially responsible firms repeatedly achieve first-rate financial returns that meet and often beat the market
and their peers, proving morals and money may be curiously compatible, after all.”

Narayan Murthy, founder chairman of Infosys also emphatically said:

“A sound value system is what differentiates long-term players from others. As long as the leaders articulate the value system very clearly, as long as they show by example, the company can hold on its own in any environment, even faced with intense competition and avoid the pitfalls of the likes of Enron, WorldCom, Qwest, Tyco and others.”

**Five Bottom Lines of the future**

**Economic Bottomline:** Wealth-creation is the most basic and fundamental dharma of business. A business organization which doesn't create wealth for the society is adharmic, unethical. We have to focus more on the causative factors which lead to these economic goals like for example, Technology, Productivity, Quality, Customer, Service, Innovation or "knowledge". These are the key-factors of the Economic Bottomline.

**Human Bottomline:** The Key Result Areas in this domain are those factors which lead to a better quality of the work-force like for example, Leadership, Teamwork, Motivation, Creativity, Ethics, Values and Wellness.

**Social Bottomline:** An organization is an integral part of the larger social environment. In the long-term, well-being of the organization depends on the wellbeing of the society. This is the rationale behind the concept of Corporate Social Responsibility (CSR) which is gaining increasing acceptance among corporate
leaders. However, here also the concept and practice of CSR has to progress beyond isolated charitable projects to embrace the community as a whole.

A business organization is not merely an economic entity but also a social organism, a human community. The highest aim of CSR must be to integrate the communal life of the organization with the communal life of the surrounding environment and harmonise the organizational goals with the developmental goals of the larger community of which it is a part. In this broader perspective, the corporation has to share with the community not only its wealth but also some of its capabilities or expertise.

There is a concentration of resources, knowledge, competence and skill in a business organization, which it has to share with the community of which it is a part.

Among business leaders, J.R.D. Tata had a clear perception of this responsibility and also the potentiality of business for community development. He said "Every company has a special continuing responsibility towards the people of the area in which it is located. The company should spare its engineers, doctors, managers to advise the people of the villages and supervise new developments undertaken by cooperative effort between them and the company." We must note here that JRD's conception of corporate responsibility goes far beyond charity or sharing of wealth towards sharing of capabilities.

Environmental Bottomline: We are not only part of society but also part of Nature. Any human group which draws energy and resources from Nature has a responsibility to use them prudently within the laws and limits set by Nature. Here again as with CSR, the highest aim of ecological responsibility is to harmonize the communal life of the group (especially the economic and material life) and the resource-energy management strategies, with the laws of Nature and the natural environment. However, for long-term effectiveness, social and ecological bottomlines should not remain as mere decorative, idealistic, showy "projects" at the fringe of the corporate life. They have to become part of the core strategy of the organization.

Evolutionary Bottomline: This is something which has not been recognized in the corporate world.

We humans, as a species, are an unfinished project. We have not yet realized all our potentialities hidden within us, especially in the moral, psychological and spiritual realms of our consciousness. We have to progress or evolve further to reach our highest potential as human being. The work and life of the modern corporate world provides a rich field of experience not only for professional growth but also for evolution of the individual. For someone who is seeking for moral and spiritual development, the corporate world provides a more effective field of experience for accelerated inner growth than an isolated ashram, monastery or forest. The problems, difficulties, challenges, temptation and conflicts of the corporate world, are a fertile arena for becoming fully conscious of our weaknesses and strengths and also for expressing our inner potentialities. Secondly, the modern corporate experiences provide the right anvil for testing the quality and genuineness of our inner growth.

But a corporate leader or manager may ask: How can it be called a bottom-line? Why should a business organization bother about the personal growth of the employees, which is his personal business? There are two reasons why. The first reason is that personal growth will have its ultimate impact on the four bottom lines. Most of the moral and spiritual disciplines can also make the employee a better professional.

For example the discipline of inner peace, equanimity and loving kindness to all which are common disciplines in all eastern spiritual traditions can lead to greater clarity in thought, better judgement, more effective decision-making, less stress and a more harmonious interpersonal relationship or team-work. Similarly the spiritual discipline of karma yoga can lead to a greater efficiency, creativity and skill in action.

The second reason is that prophetic insights of seers have perceived this inner growth in the moral
psychological and spiritual realms as the next step in human evolution and whichever group takes up this higher evolution as a part of its vision and strategy will be among the leaders of the future.

As Sri Aurobindo said,

"In the next stage of human progress it is not a material but a spiritual, moral and psychical progress that has to be made" and therefore "whatever race or country seizes on the lines of that new evolution and fulfills it will be the leader of humanity."

ORGANISATION STRUCTURE AND ETHICS

An organization’s structure is important to the study of business ethics. In a centralized organization, decision-making authority is concentrated in the hands of top-level managers, and very little authority is delegated to the lower levels. Responsibility, both internal and external, rests with top management. This structure is especially suited for organizations that make high-risk decisions, and whose lower-level managers are not highly skilled in decision-making. It is also suitable for organizations in which production processes are routine and efficiency is of primary importance.

These organizations are usually extremely bureaucratic, and the division of labour is typically very well defined. Each worker knows his/her job and what is specifically expected of him/her, and each has a clear understanding of how to carry out assigned tasks. Centralized organizations stress on formal rules, policies, and procedures, backed up by elaborate control systems. Their codes of ethics may specify the techniques to be used for decision-making.

Because of the top-down approach and the distance between employee and decision-maker, centralized organizational structures can lead to unethical acts. If the centralized organization is very bureaucratic, some employees may behave according to “the letter of the law” rather than the spirit.

In a decentralized organization, decision-making authority is delegated as far down the chain of command as possible. Such organizations have relatively few formal rules, coordination and control are usually informal and personal. They focus on increasing the flow of information. As a result, one of the main strengths of decentralized organizations is their adaptability and early recognition of external change. This provides greater flexibility to managers and they can react quickly to changes in their ethical environment. Weakness of decentralized organizations lies in the fact that they have difficulty in responding quickly to changes in policy and procedures established by the top management. In addition, independent profit centers within a decentralized organization may sometimes deviate from organizational objectives.

Organisational structure touches on many issues related to ethics. Such as:

1. The alienation experienced by workers doing repetitive work
2. The feelings of oppression created by the exercise of authority
3. The responsibilities heaped on the shoulders of managers.
4. The power tactics employed by managers who are anxious to advance their career ambitions.
5. Health problems created by unsafe working conditions.
6. The absence of due process for non-unionised employees.

A manager of any organization must ensure consistency between the structures of the organization, the scale of its operations, the tasks at hand, the needs of all stakeholders and the strategic direction of the organization. This consistency between structure and operations distinguishes successful organizations from less successful ones. According to Kreitner and Kinicki (2001, p.92), there is a tendency among managers to
act unethically in the face of perceived pressure for results. Terms of employment and compensation schemes can also create incentives for unethical conduct (Carson, 2003). This can cause managers to unwittingly set the stage for unethical shortcuts by employees who seek to please the organization. Adequate training, good communication channels and a cooperative working environment within the hierarchies can help reduce the unethical practices. The rewarding of ethical behavior can be a practice organizations can adopt. The rewards could come in the form of recognition or praise and not necessary money (Minkes, Small, Chatterjee, 1999). This can help promote and encourage ethical behavior within the organization.

Conflict of interest in business arises when an employee or manager of a company is engaged in carrying out a task on behalf of the company and the employee has private interest in the outcome of the task:

1. Possibly antagonistic to the best interests of the company
2. Substantial enough that it does or reasonably might affect.
3. The independent judgement of the company expects the employee to exercise on its behalf.

### Four fundamental ethical principles

#### The Principle of Respect for autonomy

Autonomy is Latin for "self-rule" We have an obligation to respect the autonomy of other persons, which is to respect the decisions made by other people concerning their own lives. This is also called the principle of human dignity. It gives us a negative duty not to interfere with the decisions of competent adults, and a positive duty to empower others for whom we’re responsible.

Corollary principles: honesty in our dealings with others & obligation to keep promises.

#### The Principle of Beneficence

We have an obligation to bring about good in all our actions.

Corollary principle? We must take positive steps to prevent harm. However, adopting this corollary principle frequently places us in direct conflict with respecting the autonomy of other persons.

#### The Principle of nonmaleficence

(It is not "non-malfeasance," which is a technical legal term, & it is not "nonmalevolence," which means that one did not intend to harm.)

We have an obligation not to harm others: "First, do no harm. Corollary principle: Where harm cannot be avoided, we are obligated to minimize the harm we do. Corollary principle: Don’t increase the risk of harm to others. Corollary principle: It is wrong to waste resources that could be used for good.

**Combining beneficence and nonmaleficence:** Each action must produce more good than harm.

#### The Principle of justice

We have an obligation to provide others with whatever they are owed or deserve. In public life, we have an obligation to treat all people equally, fairly, and impartially.

**Corollary principle:** Impose no unfair burdens.

**Combining beneficence and justice:** We are obligated to work for the benefit of those who are unfairly treated.
ETHICAL DILEMMA

Dilemma is a situation that requires a choice between options that are or seem equally unfavorable or mutually exclusive. By definition, an ethical dilemma involves the need to choose from among two or more morally acceptable courses of action, when one choice prevents selecting the other; or, the need to choose between equally unacceptable alternatives (Hamric, Spross, and Hanson, 2000).

A dilemma could be a right vs. wrong situation in which the right would be more difficult to pursue and wrong would be more convenient. A right versus wrong dilemma is not so easy to resolve. It often involves an apparent conflict between moral imperatives, in which to obey one would result in transgressing the other. This is also called an ethical paradox.

An ethical dilemma involves a situation that makes a person question what is the 'right' or 'wrong' thing to do. They make individuals think about their obligations, duties or responsibilities. These dilemmas can be highly complex and difficult to resolve. Easier dilemmas involve a 'right' versus 'wrong' answer; whereas, complex ethical dilemmas involve a decision between a right and another right choice. However, any dilemma needs to be resolved.

Addressing Ethical Dilemmas

The ethical dilemma consideration takes us into the grey zone of business and professional life, where things are no longer black or white and where ethics has its vital role today. A dilemma is a situation that requires a choice between equally balanced arguments or a predicament that seemingly defies a satisfactory solution.

An ethical dilemma is a moral situation in which a choice has to be made between two equally undesirable alternatives. Dilemmas may arise out of various sources of behaviour or attitude, as for instance, it may arise out of failure of personal character, conflict of personal values and organizational goals, organizational goals versus social values, etc. A business dilemma exists when an organizational decision maker faces a choice between two or more options that will have various impacts on (i) the organization’s profitability and competitiveness; and (ii) its stakeholders. ‘In situations of this kind, one must act out of prudence to take a better decision.

Case studies on Ethical dilemma

Example 1 Peeps into Mythology

Let’s have a read of this episode from the Mahabharata.

At the end of imparting training in archery and other martial skill to all the Pandavas and Kauravas, Dronacharya, their mentor, called up Arjuna and conferred on him the Supreme brahmastra.

Ashwatthama, Drona’s own son and a Kauravite, was incensed at this and argued with his father:

‘What disparity it is to deny the brahmastra to your own son, and bestow it upon Arjuna? I simply cannot take this lying down. You must give one to me too…’

Drona refused to yield. But the obstinate pressure tactics used by Ashwatthama aroused the sentimental father in Drona, and he gave away another piece of brahmastra to his son.

Why was Drona so reluctant for long to equip Ashwatthama with this deadliest of weapons?

We have to wait for an answer to this question in the climactic phase of the Mahabharata war, when the

1 Ref: Foundations of Managerial Work: Contributions from Indian Thought by S. K. Chakraborty
leading Kauravites had fallen in Kurukshetra, and Ashwatthama was at the helm. Violating the strictest injunction of Drona against the use of the brahmastra, to both Arjuna and Ashwatthama, the latter hurled it to annihilate the Pandavas in a fit of impetuous anger. The whole earth was in peril because of the impending collision of the two weapons, for Arjuna too had released his weapon in self-defense. Sensing the imminent catastrophe, the Sage Vyasa tried to mediate and prevail on them both. Arjuna responded, and could withdraw the weapon he had shot, but Ashwatthama lacked such capacity. Vyasa did devise a poignant compromise to avert the total devastation which the unretracted weapon of Ashwatthama could have wrought.

What are the insights embedded in this two-stage drama?

- **Drona** discriminated in favour of Arjuna and against Ashwatthama on the ground of values alone. He knew, as a guru, that his son may be no less than Arjuna in skill, but his value-system was in a mess.
- **Drona** was conscious of the reality that powerful instruments in the hands of ‘value-weak’, ‘skill-strong’ individuals are apt to be used destructively. Before and since Drona’s time the world has witnessed countless such events.
- The acharya in Drona could initially snub and bridle the father in him. Yet later on, even a man of his willpower and wisdom succumbed to familial emotions. How much more demanding then is the task of cultivating and retaining objectivity in managerial roles donned by much lesser mortals! Unaware, the values of much-hyped objectivity in decision-making are caught in the quick-sands of subjectivity.
- Individuals with a strong sense of values can rise above temporary provocations, can contain their small egos without nursing a feeling of humiliation or loss of face, even when required to dispense with a legitimate retaliatory move. This magnanimity is what Arjuna demonstrated when Vyasa pleaded with him. Is this weakness or strength?

**Example 2**

In a large public sector undertaking the corporate chief of finance was long engaged in a duel with one of the profit centre heads for establishing supremacy in financial decisions. Tragically, the profit centre accountant became the shuttlecock in this game. For observing corporate financial norms he was answerable to the corporate finance chief. But when he would report financial irregularities, after repeated prior information to the profit centre head, to the corporate boss, his life would be made difficult by the former. If he did not report, the CFO would be at his throat. The sensible solution would seem to be that the two bosses met and resolved their conflicts. But that would never happen – each party continuing to use the junior accountant to fight out their egoistic battles through proxy. Both the bosses were pursuing a contingency approach – each waiting for the other to make the first move. One of the ultimate outcomes of these egoistic tussles was the quitting of the demoralized junior accountant after a few months.

**Example 3**

The Managing Director-designate of a pharmaceutical company had presented the General Manager – Finance with an entertainment bill of ₹15,000/- for reimbursement. But there were no vouchers. The GM was in a moral fix, for, even LTC allowances to junior officers were being denied unless accompanied by proper papers. So the GM mustered enough courage to talk about the matter with the MD. It transpired that apparently this sum was spent by him in Delhi to entertain certain senior officials who held the key to his confirmation as the MD (he happened to be an MBA from a leading management institute). The entire accounts department was in a stir with this episode. It was a culture-shock for them because the recently-

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2 Ref: Foundations of Managerial Work: Contributions from Indian Thought by S. K. Chakraborty, p.32,36
retired MD had for years shown impeccable integrity in such matters. But the new MD seemed to grab his pound of flesh – at any cost.

Example 4

First-hand experience of Mr. A.K. Chattopadhyay, Sr. Vice President of ACC Ltd., Refractories Divisions, Nagpur, India. Formerly he was Executive Director, Tata Refractories Ltd. And Deputy Chairman of IRMA.

One incident happened sometime back when a man who had previously worked for ACC supplied and installed some refractory material to one of our customers. He represented himself to his customer as an ACC employee and claimed that the material had come from ACC, which was not true. So the client agreed to let him do the work because he used the ACC name. It so happens that the work that he did failed after two months.

The customer came to me and talked with me about what had happened. I went through all the purchase orders, but could not find one for that specific job. Then he mentioned the name of the man who did the work. I told him that that man had not worked for us for over six months. The customer assured me that this man told him that he worked for ACC and that he was using ACC materials.

In this situation, we had no legal obligation. The work was not done by our people or with our materials. But I felt it was our moral responsibility to stand behind this job because this customer gave the job to this man based on the ACC name. I replaced the material and sent my engineer out to install it. We lost heavily as there was no income whatsoever on this job. Even though I faced a lot of audit queries about this, I had the support of ACC management behind me.

People who want to be spiritual-based leaders sometimes face conflict when they try to listen to their inner self. They are sometimes afraid to follow their conscience because they do not want to lose money. When I gave the approval to have our people install new material for this job, that we had not originally done, losing a lot of money on it, I clearly told our people, “I am willing to take this loss, because I know there is a much bigger gain.” This is the dilemma that we must face sometimes, when we listen to our inner voice. We will face opposition and difficulties. However, the more the aspiring spiritual-based leaders do this, the more they will be successful. As a leader I must also help them to achieve these successes. As there are successes, then they will grow in their courage to continue on this path to being a spiritual-based leader.’

Example 5

V. V. Ranganathan, Senior Partner, Ernst & Young, India, having vast experience in corporate arena shared his experience how he handled a major mistake. Let’s go through the real life story.

Ernst & Young has a worldwide practice called Environment Management Services that helps governments and industries to address pollution and other environmental problems. ‘In one project, there was a preliminary environmental management report that was submitted to the consulate authorities in order to clear a project that involved the construction of a dam. In a study like this, you must study the flora and fauna to determine what would happen to the environment if the dam were built in this area. You must also study the people to determine the social consequences of building this dam. Based on the report that we submitted, it then had to go on to a national board before permission could be given to start the project.

Unfortunately, an overenthusiastic young man, who had only been in our firm for about six months, was working in this area. He had been trained as an environmental engineer in the USA. He cleared the

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3 Leading with Wisdom by Peter Pruzen
4 Leading with Wisdom by Peter Pruzen, p.244
environmental report in less than a week; this was something impossible to do within our firm’s normal review process. What he actually did was to use a draft from another report without going through our review process. Then he sent the report to the state board on our letterhead, and they adopted it.

“There were a lot of environmental activists who wanted the building of the dam to be stopped and they suspected that this clearance had been done to please the company which was going to build the dam there. So the press picked it up and said that Ernst & Young was a big fraud in how they cleared this large environmental project report.

‘I got a lot of calls from the press because they saw this as a very juicy story. When a journalist came to my office we had a totally different conversation. I asked him, “If someone brought you a story and you published it in good faith, and then you found out it was completely wrong, what would you do? You would come with an apology the next day. This is exactly what has happened here. The firm has not done anything wrong. It is unfortunate that a very immature person who was in his position for less than six months did this. We are very sorry that this has happened. We have officially withdrawn the report and we have agreed to not handle this assignment for our client.”

‘We got many e-mails from environmental groups in the USA, Canada and Europe. I would patiently take each one of them and reply. My spiritual theme of “seeing God in everyone” helped me in this situation a lot. It allowed me to come out with the truth and to put it into perspective. It helped me to speak from a conscious mind with no ulterior motives whatsoever. It helped me to not get mentally agitated at all. I believe that it is only because of this spiritual basis that I could be so tranquil inside.’

Example 6

Surya meets his best childhood buddy Arnav after a decade. Surya had settled down in a different country after completing higher studies and has just returned to the country with a new job at a very senior position in a multi-national company.

Surya discovers that the warmth, camaraderie, openness and joy that they had felt years before had matured instead of fading out.

When Surya asks Arnav about his work, Arnav initially avoids but on coaxing reveals that he is having serious issues at his office where his colleagues are taking undue advantage of his simplicity and sincerity. He knows that Arnav has this innate goodness in him and is aware that this can be taken advantage of by others. On further probing Surya comes to know that Arnav works in the same organization that he will be joining but at several levels lower in hierarchy. But he abstains from revealing this to Arnav.

Surya joins the organization on the scheduled date and as expected, after a few days, Arnav comes to know of this. Arnav visits Surya in his personal chamber and congratulates him. He seems to be genuinely happy that both the friends share the same workplace.

Concerned that Arnav may make a habit of visiting him often in office as a friend sending wrong signals to others, Surya gently but expressly tells Arnav to maintain the hierarchical decorum in office. Arnav does not return to his chamber after that day but the office grapevine finds out about their childhood friendship.

After a few days, Arnav’s appraisal report comes to Surya for his approval. He is shocked to find below average grades in almost all the parameters of performance. He knows this cannot be a correct assessment but hesitates to probe into this. He is concerned that his thoughts may be prejudiced or may be considered prejudiced by the others. So he signs the report. Consequently, Arnav, who is truly honest, sincere and dedicated to his work, is denied once more of his due appreciation from the organization.
Example 7

*Ramesh* is in charge of the stationary department of a large software organization. Employees who need notepads, pens, scissors, and such stationary items enter their employee id, department name, project name and the items that they take in a register that he maintains. The organization has about a 10,000 employees and there are hundreds of entries in the register. At the end of the day, he enters these entries into the computer and updates stock. No one crosschecks the manual entry with the data entered in the system.

At home, he is the only bread-earner of a relatively large family with 3-4 school-going children. One of the children needed a special marker pen for a project in his school. It is quite an expensive pen and would make *Ramesh* go beyond his monthly budget.

Suddenly *Ramesh* realizes that the inventory that he maintains has these pens and various projects frequently uses these. There is an initial hesitation rising in him which he dismisses with the reason that the loss is less than negligible to the organization while it will be an enormous financial relief to him. Thinking thus, he makes an additional entry in the system for the pen against a project and picks it up for the child at home. When his wife asks him about the price, he mumbles a random value to her.

**Steps to Resolving an Ethical Dilemma**

1. **What are the options?**
   List the alternative courses of action available.

2. **Consider the consequences**
Think carefully about the range of positive and negative consequences associated with each of the different paths of action available.

- Who/what will be helped by what is done?
- Who/what will be hurt?
- What kinds of benefits and harms are involved and what are their relative values?
- What are the short-term and long-term implications?

3. Analyse the actions

Actions should be analysed in a different perspective i.e. viewing the action per se disregard the consequences, concentrating instead on the actions and looking for that option which seems problematic. How do the options measure up against moral principles like honesty, fairness, equality, and recognition of social and environmental vulnerability? In the case you are considering, is there a way to see one principle as more important than the others?

4. Make decision and act with commitment

Now, both parts of analysis should be brought together and a conscious and informed decision should be made. Once the decision is made, act on the decision assuming responsibility for it.

5. Evaluate the system

Think about the circumstances which led to the dilemma with the intention of identifying and removing the conditions that allowed it to arise.

RESOLVING ETHICAL DILEMMA – A CASE STUDY

You are a senior manager in a major firm of investment managers.

Your employer is an international firm with a publicly stated commitment to the highest standards of ethical behaviour. The company is making losses and is due to make a very important presentation to a major corporate client, and if the deal falls through it would turn around the company. Management feels that this activity will provide a lucrative return to the successful bidder for the business and a number of major investment managers have been asked to make presentations.

Your firm is keen to win the mandate for the business and has committed considerable resources to its bid, for which initial presentations were held last week. Following the initial presentation, you learn that the proposal was well received and you are on the shortlist against only one other major firm. You realize that there is a substantial variation in the bid from the original presentation but you leave it to the judgement of the team. It is soon discovered by you that your team had got hold of the bid book of the competitor which was inadvertently left by them in the waiting room.

In business, howsoever highly competitive, there are rules and principles to ensure that certain ethical standards are maintained.

The ethical dilemma projected in this case should be resolved. Applying the steps to resolving an ethical dilemma:

STEP I — List the alternative courses of action available.
What are the Options?

(i) Keep quiet and let things take their own course.
(ii) Inform the company seeking the bid about the incident and let them decide whether to have a re-bid or not.
(iii) Inform your competitor about the incident and let them decide whether to seek for a re-bid or any other corrective measures at their end.
(iv) Withdraw the tender/bid and let the competitor get the deal.

STEP II—What are the consequences and evaluation of action?

Think carefully about the range of positive and negative consequences associated with each of the different paths of action available.

- Who/what will be helped by what is done?
- Who/what will be hurt?
- What kinds of benefits and harms are involved and what are their relative values?
- What are the short-term and long-term implications?

Option 1

(i) In all probability the deal would be awarded to my company. The competitor was careless in leaving the bid-book, and therefore there is nothing wrong if my team took advantage of the situation. In any case, it is in the best interest of the company.
(ii) There is however a risk that the competitor would discover his mistakes and approach the company seeking the bid company for a re-bid. In that eventuality, the reputation of my company “as being committed to the highest ethical standards” will get affected. In addition, my company would not get the deal.

Option 2

(i) The company seeking the bid, inspite of knowing about the incident, may award the deal to my company and not take any cognizance of the incident keeping in view the cost of the tendering process, the time involved, etc. or may decide to seek bids again.
(ii) May award the deal to the competitor by disqualifying my company.
(iii) May seek a re-bid.

Option 3

(i) The competitor, in spite of being aware of the incident, may decide not to take up the matter with the company seeking bids, which may get me the deal.
(ii) The competitor may approach the company seeking the bid. I inform them about the incident and tell them that they were informed by my company about the same, and may : (a) either seek the company making the bid to seek bids again or; (b) let them decide whether or not to seek the bid again.

Option 4

The deal would rightfully have been awarded to the competitor but for the incident, and hence it is most appropriate that my company should withdraw.
STEP III—Make decision and act with commitment

Both the parts of the analysis should be complied and conscious decision should be made. Once the decision is made, it has to be followed through with commitment irrespective of the consequences.

STEP IV—Evaluate the system.

What my team did was ethically wrong. Even if the bid book was carelessly left by the competitor, my team had no right to capitalize on the same. They should have returned it to the competitor. In any case, the competitors would have discovered their mistake. This would put the reputation of my company at stake.

The employees of the company need to be sensitized about the ethical practices and the culture of the company through appropriate training.

CODE OF ETHICS

Managers at all levels and in all functional areas face ethical issues. In fact, there is seldom a decision wherein an ethical dimension is not involved. Matters of right and wrong, just and unjust, and fairness and unfair arise frequently. In order to deal with these issues, managers need some guidelines. Organisations, formulate both business and non-business guidelines in the form of a code of conduct or code of ethics. The need for a corporate code of conduct has increased due to frequent corporate scandals, inside trading and misuse of funds. With globalisation of business, more and more companies are developing a code of ethics to be observed. Moreover, every profession has a code of conduct for its members. The Institute of Company Secretaries of India, Medical Council of India, Bar Council, All India Management Association (AIMA) and other professional bodies have their own professional codes.

A corporate code of conduct may be defined as a document containing the core values and moral principles which all those working in the company are expected to follow in the course of their duties as well as in their daily activities. It reflects commitment of the company to ensure ethical behaviour on the part, of its members. It also indicates how an employee should act in general or in specific situations. A code of conduct lays down ‘do’s’ and ‘don’ts’. It describes socially acceptable and responsible behaviour. Hence, a code of ethics is a tangible guide to ethically desirable behaviour.

It is a corporate code of conduct that helps its members to promote high standards of ethics and practice. It makes them aware of ethical dilemmas; and by adhering to these codes of conduct, business people can observe elevated standards of conduct and personal integrity so as to win the trust and confidence of the stakeholders.

A code of ethics should reflect top managements’ desire for compliance with the values, rules, and policies that support an ethical climate. The development of a code of ethics should involve the President, Board of Directors, and Chief Executive Officers who should be implementing the code. Legal staff should also ensure that the code has assessed key areas of risk correctly, and that it provides buffers for potential legal problems.

Corporate code of ethics often contains six core values or principles in addition to more detailed descriptions and examples of appropriate conduct. The six values that are desirable for codes of ethics include: (1) trustworthiness, (2) respect, (3) responsibility, (4) fairness, (5) caring, and (6) citizenship.

Explanation: For this purpose, the term “Senior Management” involves the personnel of the company, who are members of its core management team, excluding Board of Directors. Normally, this would comprise all
members of management one level below the executive directors, including all functional heads.

In the United States of America, Section 406 of the Sarbanes Oxley Act, 2002 requires public companies to disclose whether they have codes of ethics, and also to disclose any waivers of those codes for certain members of senior management. Section 406(a) of the Regulation requires companies to disclose:

- whether they have a written code of ethics that applies to their principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions;
- any waivers of the code of ethics for these individuals; and
- any changes to the code of ethics.

If companies do not have a code of ethics, they must explain why they have not adopted one. A company may file its codes as an exhibit in the annual report, post the codes on the company’s website, or agree to provide a copy of the codes upon request and without charge.

To create a code of ethics, an organization must define its most important guiding values, formulate behavioural standards, review the existing procedures for guidance and direction and establish the systems and processes to ensure that the code of conduct is implemented and effective. Codes of ethics are not easily created from boilerplate. Ideally, the development of a code is a process in whereby Boards and senior management actively debate and decide core values, roles, responsibilities, expectations, and behavioural standards.

Thus, the code of ethics outlines a set of fundamental principles which could be used as the basis for operational requirements (things one must do), operational prohibitions (things one must not do). It is based on a set of core principles and values and is by no means designed for convenience. The employees subjected to the code are required to understand, internalize, and apply it to situations which the code does not specifically address. Organizations expect that the principles, once communicated and illustrated, will be applied in every case, and that failure to do so may lead to disciplinary action.

**INDIAN ETHOS**

The essence of good governance and leadership lies not in the paraphernalia of systems and procedures but on the quality of people who create, govern or operate the systems. In Indian ethos it is known as Swadharma of each individual.

What depends the quality of the people? It is Consciousness. The essence of a human being is consciousness. And the quality of our consciousness is not determined by the IQ of our intellect. The swindlers behind most of the scams are high IQ guys. Who brought down Lehman Brothers and sank the world-economy into the waters of recession? They are the super smart MBAs of top B-schools of the world.

This is the reason why an intellectual and emotional awakening of the surface nature to ethical values, though helpful as a beginning, is not enough for a deep and lasting moral change.

Rational analysis, case studies and stories are helpful in creating a preliminary ethical awakening in our surface nature and in our thinking mind. But this awakening does not have sufficient force to overcome a strong and compelling temptation or the gust of nature. The lure and temptation is all the more difficult to resist when it is sugar-coated with pleasure and immediate gratification.

Here one example from Mahabharata is very relevant. In Mahabharata Duryodhana once said, “I know what is right, but I have no inclination for it. I also know what is not right, but I can’t resist it.” It recalls the famous verse of Pandava Gita:
This is the central knot of the immemorial ethical problem. According to Indian ethos the long-term solution lies in an inner discipline or education which brings a greater light, strength, energy and discrimination to our mind and heart and our higher aspirations and ultimately transforms our consciousness and life. There are many such disciplines in the spiritual traditions of the world, especially in the Eastern and Indian Yoga. However the mental, moral and psychological discipline described in these Indian spiritual traditions provides a practical system of "value education" which can lead to a deeper and more lasting moral transformation than the mostly intellectual and superficial approach to ethics taught in modern academic and management education.

The present ethical debate in the corporate world is focused mostly on values like honesty, integrity, fairness or transparency. But the scope of ethics is not confined to these values only.

**CODE OF CONDUCT**

The Code of conduct or what is popularly known as the Code of Business Conduct contains standards of business conduct that must guide actions of the Board of Directors and senior management of the company. The Code of Conduct outlines specific behaviours that are required or prohibited as a condition of ongoing employment. The code of conduct for a group or organization is an agreement on rules of behavior for the members of that group or organization. Commonly generated by corporations themselves, corporate codes of conduct vary extensively in design and objective. Crucially, they are not directly subject to legal enforcement. In an era acutely aware of the dramatic social and environmental effects of corporate activity across the world, such codes of conduct have become the focus of considerable attention.

A well-written code of conduct clarifies an organization’s mission, values and principles, linking them with standards of professional conduct. The code articulates the values the organization wishes to foster in leaders and employees and, in doing so, defines desired behavior. As a result, written codes of conduct or ethics can become benchmarks against which individual and organizational performance can be measured.
Additionally, a code is a central guide and reference for employees to support day-to-day decision making. A code encourages discussions of ethics and compliance, empowering employees to handle ethical dilemmas they encounter in everyday work. It can also serve as a valuable reference, helping employees locate relevant documents, services and other resources related to ethics within the organization.

The code of conduct may include the following:

(a) Company Values
(b) Avoidance of conflict of interests
(c) Accurate and timely disclosure in reports and documents that the company files before Government agencies, as well as in the company’s other communications
(d) Compliance of applicable laws, rules and regulations including Insider Trading Regulations
(e) Maintaining confidentiality of the company affairs
(f) Standards of business conduct for the company’s customers, communities, suppliers, shareholders, competitors, employees
(g) Prohibition for the Directors and senior management from taking corporate opportunities for themselves or their families
(h) Review of the adequacy of the Code annually by the Board
(i) No authority to waive off the Code should be given to anyone in any circumstances.

The Code of Conduct for each Company summarises its philosophy of doing business.

Although the exact details of this code are a matter of discretion, the following principles have been found to occur in most of the companies:

— Use of company’s assets;
— Avoidance of actions involving conflict of interests;
— Avoidance of compromising on commercial relationship;
— Avoidance of unlawful agreements;
— Avoidance of offering or receiving monetary or other inducements;
— Maintaining confidentiality;
— Collection of information from legitimate sources only;
— Safety at workplace;
— Maintaining and Managing Records;
— Free and Fair competition;
— Disciplinary actions against the erring person.

Difference between a Code of ethics and Code of conduct

The terms “Code of Ethics” and “Code of Conduct” are often mistakenly used interchangeably. They are, in fact, two unique documents. Codes of ethics, which govern decision-making, and codes of conduct, which govern actions, represent two common ways that companies self-regulate.
Similarities:

Both a Code of Ethics and a Code of Conduct are similar as they are used in an attempt to encourage specific forms of behaviour by employees. Ethics guidelines attempt to provide guidance about values and choices to influence decision making. Conduct regulations assert that some specific actions are appropriate, others inappropriate. In both cases, the organization’s desire is to obtain a narrow range of acceptable behaviors from employees.

Differences

With similarities, comes differences. Both are used in an attempt to regulate behavior in very different ways. Ethical standards generally are wide-ranging and non-specific, designed to provide a set of values or decision-making approaches that enable employees to make independent judgments about the most appropriate course of action. Conduct standards generally require little judgment; you obey or incur a penalty, and the code provides a fairly clear set of expectations about which actions are required, acceptable or prohibited.

MODEL CODE OF BUSINESS CONDUCT & ETHICS

Preamble

Commitment to ethical professional conduct is a MUST for every employee of the company in all of its businesses/units/subsidiaries. This code, consisting of imperatives formulated as statements of personal responsibility, identifies the elements of such a commitment. It contains many, but not all issues, employees are likely to face.

The code is intended to serve as a basis for ethical decision-making in the conduct of professional work. It may also serve as a basis for judging the merit of a formal complaint pertaining to violation of professional ethical standards.

It is understood that some words and phrases in a code of ethics and conduct document are subject to varying interpretations and that any ethical principle may conflict with other ethical principles in specific situations. Questions related to ethical conflicts can best be answered by thoughtful consideration of fundamental principles rather than reliance on detailed regulations. In case of conflict, the decision of the Board shall be final.

Applicability

This code is applicable to the Board Members and all employees in and above Officers level (hereinafter collectively referred to as “Employee(s)”). All employees must read and understand this code and ensure to abide by it in their day-to-day activities.

General Moral Imperatives

Contribute to society and human well-being

This principle concerning the quality of life of all people affirms an obligation to protect fundamental human rights and to respect the diversity of all cultures. We must attempt to ensure that the products of our efforts will be used in socially responsible ways, will meet social needs and will avoid harmful effects to health and welfare of others.

In addition to a safe social environment, human well-being includes a safe natural environment. Therefore, all of us who are accountable for the design, development, manufacture and promotion of company’s products, must be alert to, and make others aware of, any potential damage to the local or global
Avoid harm to others

“Harm” means injury or negative consequences, such as loss of property, property damage or unwanted health and environmental impacts. This principle prohibits use of men, material and technology in ways that result in harm to our consumers, employees and the general public.

Well-intended actions, including those that accomplish assigned duties, may lead to harm unexpectedly. In such an event, the responsible person or persons are obligated to undo or mitigate the negative consequences as much as possible.

Be honest and trustworthy

Honesty is an essential component of trust. Without trust an organisation cannot function effectively. All of us are expected not to make deliberately false or deceptive claims about our products/systems, but instead provide full disclosure of all pertinent limitations and problems.

Be fair and take action not to discriminate

The values of equality, tolerance, respect for others, and the principles of equal justice govern this imperative. Discrimination on the basis of race, sex, religion, age, disability, national origin, or other such factors is an explicit violation of this code.

Practice integrity in our inter-personal relationships

In our relationships with colleagues, we should treat them with respect and in good faith. We ourselves would expect them to treat us in the same way. The principle to be adopted to guard against loose talk or in its worst form, character assassination, is not to say anything behind one’s back and never utter something, which cannot be put in writing.

Honor confidentiality

The principle of honesty extends to issues of confidentiality of information. The ethical concern is to respect all obligations of confidentiality to all stakeholders unless discharged from such obligations by requirements of the law or other principles of this code.

We, therefore, will maintain the confidentiality of all material non-public information about company’s business and affairs.

<table>
<thead>
<tr>
<th>Specific Professional Responsibilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Live the Company’s Values each day.</td>
</tr>
<tr>
<td>We must live the Company’s Values each day. For quick reference our core values are:</td>
</tr>
<tr>
<td>Ownership</td>
</tr>
<tr>
<td>This is our company. We accept personal responsibility and accountability to meet business needs.</td>
</tr>
<tr>
<td>Passion for winning</td>
</tr>
<tr>
<td>We all are leaders in our area of responsibility with a deep commitment to deliver results. We are determined to be the best at doing what matters most.</td>
</tr>
<tr>
<td>People development</td>
</tr>
<tr>
<td>People are our most important asset. We add value through result driven training and we encourage and reward excellence.</td>
</tr>
</tbody>
</table>
Consumer focus
We have superior understanding of consumer needs and develop products to fulfill them better.

Teamwork
We work together on the principle of mutual trust and transparency in a boundary less organisation. We are intellectually honest in advocating proposals, including recognizing risks.

Innovation
Continuous innovation in products and process is the basis of our success.

Integrity
We are committed to the achievement of business success with integrity. We are honest with consumers, business partners and one another.

Strive to achieve the highest quality, effectiveness and dignity in both the processes and products of professional work
Excellence is perhaps the most important obligation of a professional. We must strive to achieve the highest quality, effectiveness and dignity in all that we are responsible for each day.

Acquire and maintain professional competence
Excellence depends on individuals who take responsibility for acquiring and maintaining professional competence. We must participate in setting standards for appropriate levels of competence, and strive to achieve those standards.

Know and respect existing laws
We must obey existing local, state, national, and international laws unless there is a compelling ethical basis not to do so. We should also obey the policies, procedures, rules and regulations of the company. Violation of a law or regulation may be ethical when that law or rule has inadequate moral basis or when it conflicts with another law judged to be more important. If one decides to violate a law or rule because it is viewed as unethical, or for any other reason, one must fully accept responsibility for one’s actions and for the consequences.

Accept and provide appropriate professional review
Quality professional work depends on professional reviewing and critiquing. Whenever appropriate, individual members should seek and utilize peer review as well as provide critical review of their work.

Manage personnel and resources to enhance the equality of working life
Organisational leaders are responsible for ensuring that a conducive environment is created for fellow employees to enable to deliver their best. We all, therefore, are responsible for ensuring human dignity of all our colleagues, ensuring their personal and professional development and enhancing the quality of working life.

Deal with the Media tactfully
We should guard against being misquoted and finding ourselves compromised. Our role as individuals is always to be tactful, to avoid comments, and to pass enquiries to those who are authorized to respond to them.
**Be upright and avoid any inducements**

Neither directly nor through family and other connections indirectly, should we solicit any personal fee, commission or other form of remuneration arising out of transactions involving the Company. This includes gifts or other benefits of significant value, which might be extended at times, to influence business-especially during bulk purchase of commodities for the organisation or awarding a contract to an agency, etc. We are likely to be offered various gifts by vendors/parties/agencies and people associated with the Company under different wraps or generally on personal celebrations or functions or religious festivals, etc.

**Observe Corporate Discipline**

Our flow of communication is not rigid and people are free to express themselves at all levels. However, this informality should not be misunderstood. What it means is that though there is a free exchange of opinions in the process of arriving at a decision, after the debate is over and a policy consensus has been established, all are expected to adhere to and abide by it, even when in certain instances we may not agree with it individually. In some cases policies act as a guide to action, in others they are designed to put a constraint on action. We all must learn to recognise the difference and appreciate why we need to observe them.

**Conduct ourselves in a manner that reflects credit to the Company**

All of us are expected to conduct ourselves, both on and off-duty, in a manner that reflects credit to the company. The sum total of our personal attitude and behaviour has a bearing on the standing of the Company and the way in which it is perceived within the organisation and by the public at large.

**Be accountable to our stake-holders**

All of those whom we serve be it our customers, without whom we will not be in business, our shareholders, who have an important stake in our business and the employees, who have a vested interest in making it all happen-are our stakeholders. And we must keep in mind at all times that we are accountable to our stakeholders.

“Inside information” gained from the Company or otherwise must not be used for personal gains. We undertake to comply with the Company’s Code of Conduct for Prevention of Insider Trading.

**Identify, mitigate and manage business risks**

It is our responsibility to follow our institutionalized Company’s Risk Management Framework to identify the business risks that surround our function or area of operation and to assist in the company-wide process of managing such risks, so that the Company may achieve its wider business objectives. All of us should continuously ask ourselves “What can go wrong and what am I doing to prevent it from going wrong.”

**Protect The Company’s properties**

We all are perceived as Trustees of Company’s properties, funds and other assets. We owe fiduciary duty to each stakeholder, as their agent, for protecting the Company’s assets. We, therefore, must safeguard and protect the Company’s assets against any misappropriation, loss, damage, theft, etc. by putting in place proper internal control systems and procedures and effectively insuring the same against any probable fire, burglary, fidelity and any other risk.

**Specific Additional Provisions for Board Members and Management Committee Members**

As Board/Management Committee Members

We undertake to actively participate in meetings of the Board, or the Committees thereof and the meetings of
Management Committee on which we serve.

As Board members

1. We undertake to inform the Chairman of the Board of any changes in our other board positions or relationship with other business and other events/circumstances/conditions that may interfere with our ability to perform Board/Board Committee duties or may impact the judgment of the Board as to whether we meet the independence requirements of Listing Agreement with Stock Exchanges.

2. We undertake that without prior approval of the disinterested members of the Board, we will avoid apparent conflict of interest. Conflict of interest may exist when we have personal interest that may have a potential conflict with the interest of the company at large. Illustrative cases can be:

   — Related Party Transactions: Entering into any transactions or relationship with the Company or its subsidiaries in which we have a financial or other personal interest (either directly or indirectly such as through a family member or other person or other organisation with which we are associated).

   — Outside Directorship: Accepting Directorship on the Board of any other Company that competes with the business of Company.

   — Consultancy/Business/Employment: Engaging in any activity (be it in the nature of providing consultancy service, carrying on business, accepting employment) which is likely to interfere or conflict with our duties/responsibilities towards the Company. We should not invest or associate ourselves in any other manner with any supplier, service provider or customer of the Company.

   — Use of Official position for our personal gains: We should not use our official position for our personal gains.

Compliance with the Code

As employees of the Company, we will uphold and promote the principles of this code

The future of the organisation depends on both technical and ethical excellence. Not only is it important for employees to adhere to the principles expressed in this Code, each employee should encourage and support adherence to the code by other employees.

Treat violations of this code as inconsistent association with the organisation

Adherence of professionals to a code of ethics is largely a voluntary matter. However, if any of us do not follow this code by engaging in process misconduct, the matter would be reviewed by the Board and its decision shall be final. The Company reserves the right to take appropriate action against the guilty employee.

Miscellaneous

Continual updation of code

This code is subject to continuous review and updation in line with any changes in law, changes in company’s philosophy, vision, business plans or otherwise as may be deemed necessary by the board.

ADVANTAGES OF BUSINESS ETHICS

More and more companies have begun to recognize the relation between business ethics and financial performance. Companies displaying a "clear commitment to ethical conduct" consistently outperform those companies that do not display an ethical conduct.
A company that adheres to ethical values and dedicatedly takes care of its employees is rewarded with equally loyal and dedicated employees.

1. Attracting and retaining talent

People aspire to join organizations that have high ethical values. Such companies are able to attract the best talent. The ethical climate matters a lot to the employees. Ethical organizations create an environment that is trustworthy, making employees willing to rely on company's policies, ability to take decisions and act on those decisions. In such a work environment, employees can expect to be treated with respect, and will have consideration for their colleagues and superiors as well. Thus, company's policies cultivate teamwork, promote productivity and support employee-growth.

Retaining talented people is as big a challenge for the company as getting them in the first place. Work is a mean to an end for the employees and not an end in itself. The relationship with their employer must be a win-win situation in which their loyalty should not be taken for granted. Talented people will invest their energy and talent only in organizations with values and beliefs that matches their own. In order to achieve this equation, managers need to build culture, compensation and benefit packages, and career paths that reflect and foster certain shared values and beliefs.

2. Investor Loyalty

Investors are concerned about ethics, social responsibility and reputation of the company in which they invest. Investors are becoming more and more aware that an ethical climate provides a foundation for efficiency, productivity and profits. Relationship with any stakeholder, including investors, based on dependability, trust and commitment results in sustained loyalty.

3. Customer satisfaction

Customer satisfaction is a vital factor of a successful business strategy. Repeated purchases/orders and an enduring relationship with mutual respect is essential for the success of the company. The name of a company should evoke trust and respect among customers for enduring success. This is achieved by a company only when it adopts ethical practices. When a company with a belief in high ethical values is perceived as such, the crisis or mishaps along the way is tolerated by the customers as minor aberrations. Such companies are also guided by their ethics to survive a critical situation. Preferred values are identified and it is ensured that organizational behavior is aligned to those values. An organization with a strong ethical environment places its customers’ interests as foremost. Ethical conduct towards customers builds a strong competitive position for the company. It promotes a strong public image too.

4. Regulators

- Business should act ethically not only to benefit itself and to build its reputation, but also for the benefit of its key stakeholders.

Regulators eye companies functioning ethically as responsible citizens. The regulator need not always monitor the functioning of the ethically sound company. Any organisation that acts within the confines of business ethics not only earns profit but also gains reputation publicly.

To summarise, companies that are responsive to employees’ needs have lower turnover in staff.

- Shareholders invest their money into a company and expect a certain level of return from that money in the form of dividends and/or capital growth.

- Customers pay for goods, give their loyalty and enhance a company’s reputation in return for goods
or services that meet their needs.
— Employees provide their time, skills and energy in return for salary, bonus, career progression and experience.

CONCLUSION

In making ethics work in an organization it is important that there is synergy in vision statement, mission statement, core values, general business principles and the code of ethics. A commitment by corporate management to follow an ethical code of conduct confers a variety of benefits. An effective ethics programme requires continual reinforcement of strong values. Organisations are challenged with the task to make their employees live and imbibe their ethical codes and values. To ensure a right ethical climate, a right combination of spirit and structure is required.

Corporate Ethics is much needed to stress the importance of sustainability, social development, stakeholders and consumers satisfaction. It is an orientation to provide a valuable service instead of displaying more orientation for profits. Ethics, point out what is good and what is bad and also what is right or wrong. It brings to the notice of the business community the importance of honesty, sincerity and fairness which makes them alert and socially conscious. It reconciles conflicting interest of various sections of the society such as workers, shareholders, consumers, distributors, suppliers, competitors and government and thus, expedite a better relation between business and the society.

GLOSSARY OF TECHNICAL WORDS

- **Business Ethics**: Business ethics (also known as corporate ethics) is a form of applied ethics or professional ethics, that examines ethical principles and moral or ethical problems that can arise in a business environment.

- **Indian Ethos**: Indian Ethos in Management refers to the values and practices that can contribute to service, leadership and management. These values and practices are rooted in Sanathana Dharma (the eternal essence), and have been influenced by various strands of Indian philosophy.

- **CSR**: Corporate Social Responsibility is a management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders.

- **Ethical Dilemma**: An ethical dilemma or ethical paradox is a decision-making problem between two possible moral imperatives, neither of which is unambiguously acceptable or preferable. The complexity arises out of the situational conflict in which obeying one would result in transgressing another.

- **Code of Conduct**: A code of conduct is a set of rules outlining the social norms, religious rules and responsibilities of, and or proper practices for, an individual.

LESSON ROUND-UP

- Business ethics is a form of applied ethics. In broad sense ethics in business is simply the application of moral or ethical norms to business.

- The Board shall lay down a code of conduct for all Board members and senior management of the company. The code of conduct shall be posted on the website of the company.

- To create a code of ethics, an organization must define its most important guiding values, formulate behavioral standards to illustrate the application of those values to the roles and responsibilities of the persons affected, review the existing procedures for guidance and direction as to how those values and standards are typically applied, and establish the systems and processes to ensure that the code is implemented and is effective.
• An ethical dilemma involves a situation that makes a person question what is the 'right' or 'wrong' thing to do. Ethical dilemmas make individuals think about their obligations, duties and responsibilities. These dilemmas can be highly complex and difficult to resolve. Easier dilemmas involve a 'right' versus 'wrong' choice; whereas, complex ethical dilemmas involve a decision between a right and a right choice.

• **Advantages of business ethics** - attracting and retaining talent, investor loyalty, customer satisfaction and regulators.

• In making ethics work in an organization it is important that there is synergy between vision statement, mission statement, core values, general business principles and code of ethics.

**SELF-TEST QUESTIONS**

*(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)*

1. Discuss about the influence of organization climate and organizational structure on the ethics programme of a company.
2. Describe Ethical Dilemma.
3. What are the advantages of Business Ethics for an organization?
4. What are the objectives and advantages of a Code of Conduct for a company?
5. What is the difference between a Code of ethics and a Code of Conduct?
Lesson 16
Sustainability and Corporate Social Responsibility

LESSON OUTLINE

- Introduction
- Sustainable Development
- Corporate Sustainability
- Corporate Social Responsibility
- Factors influencing CSR
- CSR in India
- Global Principles and Guidelines
- Sustainability Reporting
- GRI Guidelines
- Sustainability Indices
- Business Responsibility Report
- Integrated Reporting
- Glossary
- Lesson Round-Up
- Self Test Questions

LEARNING OBJECTIVES

The objective of this study lesson is to enable the students to understand the concept, applicability and reporting in respect to Corporate Social Responsibility and Sustainability.

The basic premise is that when the corporations get bigger in size, apart from the economic responsibility of earning profits, there are many other responsibilities attached to them which are more of non-financial/social in nature. These are the expectations of the society from these corporate to give something in return to the society with whose explicit or implicit help these entities stand where they are, discussed in this lesson.

This chapter provides working knowledge on the concepts of sustainability and corporate social responsibility. This chapter may be useful in forming the advisory role in practical areas of work.

“When you are in doubt…. recall the face of the poorest and the weakest man whom you may have seen and ask yourself if the step you contemplate is going to be of any use to him? Will he gain anything by it? Will it restore him to control over his own life and destiny? That test alone can make our plans and programs meaningful.”

Mahatma Gandhi
INTRODUCTION

Sustainability means meeting of the needs of the present without compromising the ability of future generations to meet theirs. It has three main pillars: economic, environmental, and social. These three pillars are informally referred to as people, planet and profits. These three Ps have its priority orders too. One should take first take care of the PEOPLE and thereafter the PLANET. PROFIT is an economic activity and is much for the survival of the unit, but in the array of these three Ps, its priority should stand in last and not at the cost of People and Planet.

Sustainability is based on a simple principle: Everything that we need for our survival and well-being depends, either directly or indirectly, on our natural environment. Sustainability creates and maintains the conditions under which humans and nature can exist in productive harmony that permits fulfilling the social, economic and other requirements of the present and future generations.

Sustainability is important to make sure that we have and will continue to have the water, materials, and resources to protect human health and our environment.

Sustainability has been comprehensively defined in Paul Hawkin’s book – The Ecology of Commerce as:

“Sustainability is an economic state where the demand placed upon the environment by people and commerce can be met without reducing the capacity of the environment to provide for future generations. It can also be expressed in the simple terms of an economic golden rule for the restorative economy; leave the world better than you found it, take no more than you need, try not to harm life of environment, make amends if you do.”

SUSTAINABLE DEVELOPMENT

Sustainable development is a broad concept that balances the need for economic growth with environmental protection and social equity. It is a process of change in which the exploitation of resources, the direction of investments, the orientation of technological development, and institutional change are all in harmony and enhance both current and future potential to meet human needs and aspirations. Sustainable development is a broad concept and it combines economics, social justice, environmental science and management, business management, politics and law.

The goal of sustainable development is to maintain economic growth without environment destruction. Exactly what is being sustained (economic growth or the global ecosystem, or both) is currently at the root of several debates, although many scholars argue that the apparent reconciliation of economic growth and the environment is simply a green sleight of hand that fails to address genuine environmental problems.

In 1987, a report of the World Commission on Environment and Development (WCED) of the United Nations (popularly known as Brundtland Report) first introduced the concept. The Commission describes Sustainable Development as a process of change in which the exploitation of resources, the direction of investments, the orientation of technological development … instrumental change and the ability of biosphere to absorb the effects of human activities are consistent with future as well as present needs.

In an attempt to address criticism of the vagueness in the definition of sustainable development, Karl-Henrik Robert, founder of the environment organization The Natural Step, along with a group of 50 scientists sought to obtain a consensus on sustainability and developed four ‘basi, non-negotiable system conditions for global sustainability’. These include:

1. No systematic increase of substances from the earth’s crust in the ecosphere. This condition implies a drastic reduction in the use of minerals, fossils fuels and non-renewable resources.
2. No systematic increase of substances produced by society in the ecosphere. This condition means that substances cannot be produced faster that they are broken down and degraded biologically. Therefore, the uses of non-biodegradable materials must be minimized.

3. No systematic diminishing of the physical basis for productivity and diversity of nature. This condition requires preservation of biodiversity, non-environmentally damaging land use practices and use of renewable resources.

4. Fair and efficient use of resources and social justice. This implies equitable access to an just distribution of resources.

While the above four conditions may provide a more precise definition that Brundtland’s, problems of operationalizing remain; there is still considerable disagreement among the scientific community on evaluation of environmental impact of products and processes. There are also other practical issue:

- What is the base line from which we can measure ‘systematic increase’?

- Are goals of zero emissions as stated in the environmental policy statements of several transnational firms mere feel good statements or are they achievable?

In an analysis of the impact of globalization on environmental sustainability using the Natural Step framework, Osland et al. (2002) found the evidence to be ‘mixed’. They were being quite charitable in their overall assessment because while there were some positive examples of environmentally sustainable practices like energy efficiency, recycling and cleaner technologies there were more negative environmental effects like species and biodiversity depletion, soil erosion, deforestation and salinity, to name a few.

Sustainable Development indicates development that meets the needs of the present generation without compromising with the ability of the future generations to meet their needs. The principle behind it is to foster such development through technological and social activities which meets the needs of the current generations, but at the same time ensures that the needs of the future generation are not impaired. For example, natural energy resources, like Coal and Petroleum etc., should be prudently used avoiding wastage so that the future generation can inherit these energy resources for their survival also.

The contribution of sustainable development to corporate sustainability is twofold. First, it helps set out the areas that companies should focus on: environmental, social, and economic performance. Secondly, it provides a common societal goal for corporations, governments, and civil society to work towards ecological, social, and economic sustainability. However, sustainable development by itself does not provide the necessary arguments for why companies should care about these issues. Those arguments come from corporate social responsibility and stakeholder theory.

Corporate sustainability encompasses strategies and practices that aim at meeting the needs of the stakeholders today while seeking to protect, support and enhance the human and natural resources that will be needed in the future.

Four fundamental Principle of Sustainable Development agreed by the world community are:

1. Principle of Intergenerational equity: need to preserve natural resources for the future generations.

2. Principle of sustainable use: use of natural resources in a prudent manner without or with minimum tolerable impact on nature.

3. Principle of equitable use or intra-generational equity: Use of natural resources by any state / country must take into account its impact on other states.
4. Principle of integration: Environmental aspects and impacts of socio-economic activities should be integrated so that prudent use of natural resources is ensured.

This was reinforced at the United Nations Conference on Environment and Development (UNCED) held in Rio de Janeiro in 1992. It is now universally acknowledged that the present generation has to ensure that the coming generations have a world no worse than ours, rather hopefully better.

The generations have been following these fundamental natural laws for thousands of years. However, scenario started changing rapidly during industrial revolution in Europe, and later on they have started growing side by side with awakening of modern society worldwide.

The U.S. Environmental Protection Agency defines Sustainable development as: "Sustainable development marries two important themes: that environmental protection does not preclude economic development and that economic development must be ecologically viable now and in the long run." Hence sustainability encompasses ideas and values that inspire people to become custodian of the environment without compromising with the economic growth.

At the 21st Conference of the Parties in Paris, Parties to the United Nations Framework Convention on Climate Change (UNFCCC) reached a landmark agreement to combat climate change and to accelerate and intensify the actions and investments needed for a sustainable low carbon future. The Paris Agreement brings all nations into a common cause to undertake take ambitious efforts to combat climate change and adapt to its effects, with enhanced support to assist developing countries to do so.

The Paris Agreement’s central aim is to strengthen the global response to the threat of climate change by keeping the global temperature rise this century well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 degrees Celsius.

On Earth Day, 22 April 2016, 175 world leaders signed the Paris Agreement at United Nations Headquarters in New York. This was by far the largest number of countries ever to sign an international agreement on a single day.

**Sustainability Development as Corporate Sustainability**

The environmental protection issues came in to the lime light when the in the 1960s to 1970s the environmental legislations were passed in the US / Europe. During that era it was seen this as the corporate responsibility to protect the environment, since the companies were taking the advantages and exploitation of the natural resources by producing the carbon and polluting the environment and water resources through the chemical base, which leads to further fertility of the soil. The Bhopal Gas tragedy which happened in 1984 is the burning example before us, how the corporate have exploited the soil and put the life in danger for generations to come.

**WHAT IS CORPORATE SUSTAINABILITY?**

Corporate sustainability indicates new philosophy, as an alternative to the traditional growth and profit-maximization model, under which sustainable development comprising of environmental protection, social justice and equity, and economic development are given more significant focus while recognizing simultaneous growth of the corporate and profitability.

It is a business approach that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments. Corporate sustainability describes business practices built around social and environmental considerations.
Corporate sustainability encompasses strategies and practices that aim to meet the needs of the stakeholders today while seeking to protect, support and enhance the human and natural resources that will be the need of the future. Corporate sustainability leaders achieve long-term shareholder value by gearing their strategies and management to harness the market's potential for sustainability products and services while at the same time successfully reducing and avoiding sustainability costs and risks.

Thomas Dyllick and Kai Hockerts in ‘Beyond the Business Case for Corporate Sustainability’ define Corporate Sustainability as, "meeting the needs of a firm's direct and indirect stakeholders (such as shareholders, employees, clients, pressure groups, and communities) without compromising its ability to meet the needs of future stakeholders as well."

The Australian government defines Corporate Sustainability as "encompassing strategies and practices that aim to meet the needs of the stakeholders today, while seeking to protect, support, and enhance the human and natural resources that will be needed in the future."

Worldwide business communities are recognizing the need to address the environmental and social impacts of their activities. The fundamental business objectives towards creating economic values, clubbed with the environmental and social value addition, evolved the concept of 'triple bottom line' under sustainable development. Corporate Boards are required to address issues, such as environment, social justice and economic efficiency to ensure their long-term existence.

Concern towards social, environmental and economical issues, i.e., covering all the segments of the stakeholders, are now basic and fundamental issues which permit a corporate to operate in the long run sustainably. Following key drivers need to be garnered to ensure sustainability:

- **Internal Capacity Building strength** – In order to convert various risks into competitive advantages.
- **Social impact assessment** – In order to become sensitive to various social factors, like changes in culture and living habits.
- **Repositioning capability** through development and innovation: Crystallisation of all activities to ensure consistent growth.
- **Corporate sustainability** is a business approach creating shareholder value in the long run.

These may be derived by converting risks arising out of economic, environmental and social activities of a corporate into business opportunities keeping in mind the principles of a sustainable development.

As a good corporate citizen, the companies are required to focus on the following key aspects:

*Organisations should set their goal towards the creation of absolute value for the society. Once it is ensured, a corporate never looks back and its sustainability in the long run is built up.*

**Ethical Corporate Practices**

In the short run, enterprise can gain through non-ethical practices. However those cannot be sustained in the long run. Society denies accepting such products or services. For example, in Drug and Pharmaceutical industry many products are today obsolete due their side effects which such companies never disclosed to protect their sales volume. Only when they were banned by the WHO or other authorities, they had to stop their production.
Worth of the Earth through Environmental Protection

Resources which are not ubiquitous and have economic and social value should be preserved for a long-term use and be priced properly after considering environmental and social costs. For example, a power plant should build up its cost model efficiently after taking into account cost of its future raw material sourcing, R&D cost for alternate energy source, cost for proper pollution control measures and so on.

Equitable Business Practices

Corporates should not indulge themselves in unfair means and should create candid business practices, ensuring healthy competition and fair trade practices.

Corporate Social Responsibility

As a Corporate citizen, every corporate is duty bound to its society wherein it operates and serves. Although there are no hard and fast rules, CSR activities need to be clubbed and integrated into the business model of the company.

Innovate new technology/process/system to achieve eco-efficiency

Innovation is the key to success. Risks and crisis can be eliminated through innovation. Learning and innovative enterprise gets a cutting edge over others. These innovative processes bring sustainability if developments are aimed at satisfying human needs, and ensure quality of life, while progressively reducing ecological impact and resource intensity to a level at least in line with earth’s estimated carrying capacity.

Creating Market for All

Monopoly, unjustified subsidies, prices not reflecting real economic, social environmental cost, etc. are hindrances to the sustainability of a business. Simultaneously, a corporate has to build up its products and services in such a way so as to cater to all segments of customers/consumers. Customer confidence is the essence of corporate success.

Switching over from the Stakeholders Dialogue to holistic Partnership

A business enterprise can advance its activities very positively if it makes all the stakeholders partner in its progress. It not only builds confidence of its stakeholders, but also helps the management to steer the business under a very dynamic and flexible system. This approach offers business, government and other stakeholders of the society to build up an alliance to bring about common solutions to the common concerns faced by all.

Compliance of Statutes

Compliance of statutes, rules and regulations and standards set by various bodies ensure clinical check up of a corporate and confers societal license upon it to the corporate to run and operate its business in the society.

Why is Sustainability an Imperative?

Sustainability is an emerging mega trend and is a measure of good corporate governance. Over the years, environmental issues have steadily encroached on businesses’ capacity to create value for the customers, shareholders, and other stakeholders. Globalized workforces and supply chains have created environmental pressures and attendant business liabilities. The rise of new world powers has intensified competition for natural resources (especially oil) and added a geopolitical dimension to sustainability. “Externalities”, such as
carbon dioxide emissions and water use are fast becoming materials—meaning that investors consider them central to a firm’s performance and stakeholders expect companies to share information about them.

These forces are magnified by escalating public and governmental concern about climate change, industrial pollution, food safety, and natural resource depletion, among other issues. Consumers in many countries are seeking out sustainable products and services or leaning on companies to improve the sustainability of traditional ones.

Further fueling this mega trend, thousands of companies are placing strategic bets on innovation in energy efficiency, renewable power, resource productivity, and pollution control. In the end, it can be concluded that the top management of an organisation can no longer afford to ignore sustainability as a central factor in their companies’ long-term competitiveness.

**Government’s Role in improving Sustainability Reporting**

Governments are interceding with unprecedented levels of new regulations, like SEBI mandated Business Responsibility Reporting in India for top listed companies besides the voluntary reporting for others. Integrated Reporting in South Africa and many other jurisdictions are placing similar requirement on companies to report about the sustainability aspects in addition to financial information.

In 2011, Ministry of Corporate Affairs (MCA), Govt. of India issued the first voluntary reporting framework for reporting on Business Responsibility in the form of ‘National Voluntary Guidelines (NVG) on Social, Environmental and Economic Responsibilities of Business’. SEBI considering the framework given under the NVG guidelines, inserted clause 55 to the listing agreement to give mandate to top 100 listed companies to adopt the Business Responsibility Framework. The other listed companies are encouraged to adopt the Business Responsibility Reporting voluntarily. The similar regulators initiatives are required in other jurisdiction also to encourage the companies to adopt the Reporting on Sustainability aspects.

Over the past 10 years, environmental issues have steadily encroached on businesses’ capacity to create value for customers.

**CORPORATE SOCIAL RESPONSIBILITY (CSR)**

Corporate Social Responsibility (CSR) is a concept whereby companies not only consider their profitability and growth, but also the interests of society and the environment by taking responsibility for the impact of their activities on stakeholders, environment, consumers, employees, communities, and all other members of the public sphere. The basic premise is that when the corporations get bigger in size, apart from the economic responsibility of earning profits, there are many other responsibilities attached to them which are more of non-financial/social in nature. These are the expectations of the society from these corporate to give something in return to the society with whose explicit or implicit help these entities stand where they are.

The vedic philosophy of “Sarva loka hitam” i.e. “the well-being of all stakeholders”, has regained importance in the current business environment. The concept has evolved over the years and now used as strategy and a business opportunity to earn stakeholder goodwill.

**Corporate Sustainability and Corporate Social Responsibility**

Although scholars and practitioners often interpret Corporate Sustainability and Corporate Social Responsibility as being nearly synonymous, pointing to similarities and the common domain. The two concepts have different backgrounds and different theoretical paths. According to management science, the notion of Corporate Sustainability can be defined first as the capacity of a firm to create value through the
product and services it produces, and to continue operating over the years. Sustainability, in this context, entails the creation of a sustainable competitive advantage.

Corporate Sustainability can be considered as an attempt to adapt the concept of Sustainable Development to the corporate setting, matching the goal of value creation with environmental and social considerations. According to the Dow Jones Sustainability Index, ‘Corporate Sustainability is a business approach that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments. The Journal of Environmental Strategy defines corporate sustainability as ‘the capacity of an enterprise to maintain economic prosperity in the context of environmental responsibility and social stewardship. Accountability, the capability of an organization to continue its activities, indefinitely, has taken due account of its impact on natural, social and human capitals.

Corporate Sustainability includes an attempt to assimilate the environmental and social dimensions into business operations: processes, products and procedures. In practical terms, the Corporate Sustainability approach leads to a very concrete and pragmatic problem; how to measure performance based on the three dimensions outlined and how natural and social values can be incorporated into corporate accounting.

The evolutionary part of the concept of Corporate Social Responsibility is different from that of the Corporate Sustainability. The first recognized contribution in the literature dates back to Bowen, who stressed the responsibilities of businesses, and wrote that social responsibility refers to the obligations of the businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society.

Besides economic and legal responsibilities (that is, to be able to make profits as well as obey the law), companies are expected to satisfy other requirements, relevant to the conformity to social norms and voluntary contributions to the community in which they operate. Another important Corporate Social Responsibility approach was developed during the 1980s in the light of the growth of the stakeholder approach. According to it, firms have obligations to a larger group of stakeholders than the simple shareholders, where a stakeholder is a group or an individual who can affect or is affected by the achievement of the firm’s objectives. Business can be understood as a set of relationships among groups which have a stake in the activities that make up the business.

Although Corporate Sustainability and Corporate Social Responsibility have different roots and have developed along diverse theoretical paths, they have ultimately converged. This strong convergence is evident in some recent definitions of the Corporate Social Responsibility provided by international organizations, like the Prince of Wales International Business Leaders Forum: Corporate Social Responsibility means open and transparent business practices that are based on ethical values and have respect for their employees, communities and environment. It is designed to deliver sustainable value to society at large, as well as to the shareholders.

The concept of sustainable development has been transposed from the macro to the corporate dimensions. Companies, in fact, are a productive resource of our socio-economic system, and key to the eventual implementation of sustainability. According to the management theory, the attempt to include sustainability issues in the managerial framework can be divided into two separate issues: Corporate Sustainability and Corporate Social Responsibility. The actualization of the theoretical pillars of Sustainability Development within Corporate Sustainability/Corporate Social Responsibility seems crucial to effectively respond to the challenges posed by sustainability.

**FACTORS INFLUENCING CSR**

Many factors and influences, including the following, have led to increasing attention being devoted to CSR:
Globalization – coupled with focus on cross-border trade, multinational enterprises and global supply chains — is increasingly raising CSR concerns related to human resource management practices, environmental protection, and health and safety, among other things.

Governments and intergovernmental bodies, such as the United Nations, the Organisation for Economic Co-operation and Development and the International Labour Organization have developed compacts, declarations, guidelines, principles and other instruments that outline social norms for acceptable conduct.

Advances in communications technology, such as the Internet, cellular phones and personal digital assistants, are making it easier to track corporate activities and disseminate information about them. Non-governmental organizations now regularly draw attention through their websites to business practices they view as problematic.

Consumers and investors are showing increasing interest in supporting responsible business practices and are demanding more information on how companies are addressing risks and opportunities related to social and environmental issues.

Numerous serious and high-profile breaches of corporate ethics have contributed to elevated public mistrust of corporations and highlighted the need for improved corporate governance, transparency, accountability and ethical standards.

Citizens in many countries are making it clear that corporations should meet standards of social and environmental care, no matter where they operate.

There is increasing awareness of the limits of government legislative and regulatory initiatives to effectively capture all the issues that corporate social responsibility addresses.

Businesses are recognizing that adopting an effective approach to CSR can reduce risk of business disruptions, open up new opportunities, and enhance brand and company reputation.

## CSR IN INDIA

### ITC - “e-Choupal”

ITC’s Agri Business Division, one of India’s largest exporters of agricultural commodities, has conceived e-Choupal as a more efficient supply chain aimed at delivering value to its customers around the world on a sustainable basis. e-Choupal’ model unshackles the potential of Indian farmer who has been trapped in a vicious cycle of low risk taking ability - low investment - low productivity - weak market orientation - low value addition - low margin - low risk taking ability. This made him and Indian agribusiness sector globally uncompetitive, despite rich & abundant natural resources.

‘e-Choupal’ leverages Information Technology to virtually cluster all the value chain participants, Real-time information and customised knowledge provided by ‘e-Choupal’ enhance the ability of farmers to take decisions and align their farm output with market demand and secure quality & productivity. The aggregation of the demand for farm inputs from individual farmers gives them access to high quality inputs from established and reputed manufacturers at fair prices. As a direct marketing channel, virtually linked to the ‘mandi’ system for price discovery, ‘e-Choupal’ eliminates wasteful intermediation and multiple handling. Thereby it significantly reduces transaction costs.

Launched in June 2000, 'e-Choupal', has already become the largest initiative among all Internet-based interventions in rural India. 'e-Choupal' services today reach out to over 4 million farmers growing a range of
Indian entrepreneurs and business enterprises have a long tradition of working within the values that have defined our nation's character for millennia. India's ancient wisdom, which is still relevant today, inspires people to work for the larger objective of the well-being of all stakeholders. These sound and all encompassing values are even more relevant in current times, as organizations grapple with the challenges of modern-day enterprise, the aspirations of stakeholders and of citizens eager to be active participants in economic growth and development.

The subject of Corporate Social Responsibility has evolved during last few decades from simple philanthropic activities to integrating the interest of the business with that of the communities in which it operates. By exhibiting socially, environmentally and ethically responsible behaviour in governance of its operations, the business can generate value and long term sustainability for itself while making positive contribution in the betterment of the society. Although we have seen a period of sustained economic growth in the current decade, we still continue to face major challenges on the human side in India. The problems like poverty, illiteracy, malnutrition etc. have resulted in a large section of the population remaining as “unincluded” from the mainstream. We need to address these challenges through suitable efforts and interventions in which all the state and non-state actors need to partner together to find and implement innovative solutions.

Indian business has traditionally been socially responsible and some of the business houses have demonstrated their efforts on this front in a laudable manner. However, the culture of social responsibility needs to go deeper in the governance of the businesses.


The main object of the Factories Act, 1948 was to ensure adequate safety measures and to promote the health and welfare of the workers employed in factories. The Act also makes provisions regarding employment of women and young persons (including children and adolescents), annual leave with wages etc.

The Employees' State Insurance Act, 1948 provided for certain benefits to employees in case of sickness, maternity and employment injury and also makes provisions for certain other matters in relation thereto.

The Employees Compensation Act, 1923 was a social security legislation. It imposes statutory liability upon an employer to discharge his moral obligation towards his employees when they suffer from physical disabilities and diseases during the course of employment in hazardous working conditions. The Act also seeks to help the dependents of the workmen rendered destitute by the ‘accidents’ and from the hardship arising out from such accidents.

In 1972, the Department of Science and Technology set up a National Committee on Environmental Planning and Coordination to identify and investigate problems of preserving or improving the human
environment and also to propose solutions for environmental problems. In 1977, by an amendment to the Constitution, Article 48A was introduced imposing a duty on the State to protect and improve the environment and safeguard the forests and wildlife of the country. Article 51A also, provided for the protection and improvement of the natural environment including forests, lakes, rivers and wildlife and to have compassion for living creatures.

In 1986, the Government enacted the Environment Protection Act to provide for the protection and improvement of environment and the prevention of hazards to human beings, other living creatures, plants and property.

The Ministry of Corporate Affairs has adopted the role of an enabler, facilitator and regulator for effective functioning and growth of the corporate sector. A number of initiatives have been taken on the legislative, service delivery and capacity building sides so that the corporate sector is provided with a buoyant and enabling regulatory environment for its growth. Simultaneously, the Ministry is also focusing on various issues related to inclusive growth in relation to the development of corporate sector.

Under the old Companies Act, 1956, there was no provision of CSR. However the CSR was introduced as Voluntary Guidelines in 2009 by the Ministry of Corporate Affairs (MCA).

Voluntary Guidelines 2009: In its preamble it was mentioned that CSR is not philanthropy and CSR activities are purely voluntary- what companies will like to do beyond any statutory requirement or obligation. To provide companies with guidance in dealing with the above mentioned expectations, while working closely within the framework of national aspirations and policies, following Voluntary Guidelines for Corporate Social Responsibility have been developed. While the guidelines have been prepared in the Indian Context, enterprises that have a trans-national presence would benefit from using these guidelines for their overseas operations as well. Since the guidelines are voluntary and not prepared in the nature of a perspective roadmap, they are not intended for regulatory or contractual use.

The Core elements of CSR Policy covered the following points:

- Care for all stakeholders
- Ethical Functioning
- Respect for Workers Rights and Welfare
- Respect for Human Rights
- Respect for Environment
- Activities for Social and Inclusive Development

Corporate Social Responsibility under the Companies Act, 2013

The Companies Act, 2013 has introduced the concept of Corporate Social Responsibility in India to the forefront. It aims to promote greater transparency and disclosure. The Ministry of Corporate Affairs notified Section 135 and Schedule VII of the Companies Act 2013 as well as the Companies (Corporate Social Responsibility Policy) Rules, 2014 deals with Corporate Social Responsibility. The provisions of the Act and the Rules amended till June 2017 are given below-

Definition of CSR

The term ‘CSR’ is defined in the Companies (Corporate Social Responsibility Policy) Rules to mean and include but not limited to:
projects or programs relating to activities specified in the Schedule VII of the Act; or
projects or programs relating to activities undertaken by the Board in pursuance of recommendations of the CSR Committee as per the declared CSR policy subject to the condition that such policy covers subjects enumerated in the Schedule VII of the Act.

**Applicability**

As per section 135 of the Companies Act 2013, the CSR provision will be applicable on companies which fulfill any of the following criteria during the immediately preceding financial year:

- Companies having net worth of rupees five hundred crore or more, or
- Companies having turnover of rupees one thousand crore or more or
- Companies having a net profit of rupees five crore or more

The CSR Rules have widen the ambit for compliance obligations to include the holding and subsidiary companies as well as foreign companies whose branches or project offices in India which fulfills the criteria specified above.

According to the CSR Rules, the CSR provision will also be applicable to every company including its holding or subsidiary, and a foreign company having its branch office or project office in India having net worth of rupees five hundred crore (500 Crore) or more, or turnover of rupees one thousand crore (1000 crore) or more or a net profit of rupees five crore (5 Crore) or more during any financial year.

If a company ceases to be a company covered under subsection (1) of section 135 of the Act for three consecutive financial years shall not be required to:

1. constitute a CSR Committee; and
2. comply with the provisions contained in sub-section (2) to (5) of the said section till such time it meets the criteria specified in sub-section (1) of section 135.

**CSR Committee**

Companies that trigger any of the aforesaid conditions must constitute a Corporate Social Responsibility Committee of the Board to formulate and monitor the CSR policy of a company. Section 135 of the 2013 Act requires the CSR Committee to consist of at least three directors, including at least one independent director. Where a company is not required to appoint an independent director under sub-section (4) of section 149, it shall have in its Corporate Social Responsibility Committee two or more directors. However, CSR Rules exempts unlisted public companies and private companies that are not required to appoint an independent director from having an independent director as a part of their CSR Committee.

Further, the CSR Rules have relaxed the requirement regarding the presence of three or more directors on the CSR Committee of the Board. In case where a private company has only two directors on the Board, the CSR Committee can be constituted with these two directors.

The CSR Committee of a foreign company shall comprise of at least two persons wherein one or more persons should be resident in India and the other person nominated by the foreign company.

The Board's report shall disclose the composition of the Corporate Social Responsibility Committee.

The relevant Rule 5 of the Companies (Corporate Social Responsibility Policy) Rules 2014 provides as under:
(1) The companies mentioned in rule 3 shall constitute CSR Committee as under.—

(i) an unlisted public company or a private company covered under sub-section (1) of section 135 which is not required to appoint an independent director pursuant to sub-section (4) of section 149 of the Act, shall have its CSR Committee without such director;

(ii) a private company having only two directors on its Board shall constitute its CSR Committee with two such directors;

(iii) with respect to a foreign company covered under these rules, the CSR Committee shall comprise of at least two persons of which one person shall be as specified under clause (d) of sub-section (1) of section 380 of the Act and another person shall be nominated by the foreign company.

(2) The CSR Committee shall institute a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the company.

**Functions of the CSR Committee**

○ The Corporate Social Responsibility Committee shall formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII.

○ The Corporate Social Responsibility Committee shall recommend the amount of expenditure to be incurred on the activities to be undertaken by the company as specified in Schedule VII.

○ Further, the CSR Committee is under an obligation to monitor the implementation of the CSR policy from time to time.

○ The CSR Committee shall also institute a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the government.

**CSR Activities:** Rule 4 which prescribes about the CSR Activities provides that:

(1) The CSR activities shall be undertaken by the company, as per its stated CSR Policy, as projects or programs or activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business.

(2) The Board of a company may decide to undertake its CSR activities approved by the CSR Committee, through-

- a company established under section 8 of the Act or a registered trust or a registered society, established by the company, either singly or along with any other company, or

- a company established under section 8 of the Act or a registered trust or a registered society, established by the Central Government or State Government or any entity established under an Act of Parliament or a State legislature:

Provided that if, the Board of a company decides to undertake its CSR activities through a company established under section 8 of the Act or a registered trust or a registered society, other than those specified in this sub-rule, such company or trust or society shall have an established track record of three years in undertaking similar programs or projects; and the company has specified the projects or programs to be undertaken, the modalities of utilisation of funds of such projects and programs and the monitoring and reporting mechanism.

(3) A company may also collaborate with other companies for undertaking projects or programs or CSR
activities in such a manner that the CSR Committees of respective companies are in a position to report separately on such projects or programs in accordance with these rules.

(4) Subject to provisions of sub-section (5) of section 135 of the Act, the CSR projects or programs or activities undertaken in India only shall amount to CSR Expenditure.

(5) The CSR projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act.

(6) Companies may build CSR capacities of their own personnel as well as those of their Implementing agencies through Institutions with established track records of at least three financial years but such expenditure including expenditure on administrative overheads, shall not exceed five per cent of total CSR expenditure of the company in one financial year.

(7) Contribution of any amount directly or indirectly to any political party under section 182 of the Act, shall not be considered as CSR activity.

**CSR Policy**

CSR Policy relates to the activities to be undertaken by the company as specified in Schedule VII to the Act and the expenditure thereon, excluding activities undertaken in pursuance of normal course of business of a company.

The Rules provide that the CSR Policy of a company shall, inter alia include the following, namely:

- A list of CSR projects or programs which a company plans to undertake falling within the purview of the Schedule VII of the Act, specifying modalities of execution of such project or programs and implementation schedule for the same; and

- Monitoring process of such projects or programs.

But the activity should not be undertaken in pursuance of normal course of business of a company. The Board shall ensure that the activities included by the company in its CSR Policy are related to the activities mentioned in Schedule VII of the Act.

The CSR Policy of the company shall specify that the surplus arising out of the CSR projects or programs or activities shall not form part of business profit of a company.

The Board after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company’s website. The Board of every company ensures that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.

Rule 6 deals with the CSR Policy, which provides that:

(1) The CSR Policy of the company shall, *inter alia*, include the following, namely:

- a list of CSR projects or programs which a company plans to undertake falling within the purview of the Schedule VII of the Act, specifying modalities of execution of such project or programs and implementation schedules for the same; and

- monitoring process of such projects or programs.
Provided that the CSR activities does not include the activities undertaken in pursuance of normal course of business of a company.

Provided further that the Board of Directors shall ensure that activities included by a company in its Corporate Social Responsibility Policy are related to the activities included in Schedule VII of the Act.

(2) The CSR Policy of the company shall specify that the surplus arising out of the CSR projects or programs or activities shall not form part of the business profit of a company.

**CSR Expenditure**

- The Board of every company shall ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy. This amount will be CSR expenditure.

- If the company fails to spend such amount, the Board shall, in its report specify the reasons for not spending the amount.

- The company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities.

- Expenditure incurred on specified activities that are carried out in India only will qualify as CSR expenditure. Such expenditure includes contribution to the corpus or on projects or programs relating to CSR activities.

- Expenditure incurred in undertaking normal course of business will not form a part of the CSR expenditure. Companies would need to clearly distinguish those activities which are undertaken specifically in pursuance of normal course of business and those that are done incrementally as part of the CSR initiatives.

- Any surplus arising out of CSR activities will not be considered as business profit for the spending company.

- Expenditure incurred by Foreign Holding Company for CSR activities in India will qualify as CSR spend of the Indian subsidiary if, the CSR expenditures are routed through Indian subsidiaries and if the Indian subsidiary is required to do so as per section 135 of the Act.

**CSR Expenditure [Rule 7]:**

CSR expenditure shall include all expenditure including contribution to corpus, or on projects or programs relating to CSR activities approved by the Board on the recommendation of its CSR Committee, but does not include any expenditure on an item not in conformity or not in line with activities which fall within the purview of Schedule VII of the Act.

**CSR Activities**

- The CSR activities shall be undertaken by the company, as per its stated CSR Policy, as projects or programs or activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business.

- The Board of a company may decide to undertake its CSR activities approved by the CSR Committee, through a registered trust or a registered society or a company established under section 8 of the Act by the company, either singly or alongwith its holding or subsidiary or associate
company, or along with any other company or holding or subsidiary or associate company of such other company, or otherwise. Provided that----

(i) If such trust, society or company is not established by the company either singly or along with its holding or subsidiary or associate company, or along with any other company or holding or subsidiary or associate company of such other company or its holding or subsidiary or associate company, it shall have an established track record of three years in undertaking similar programs or projects:

(ii) the company has specified the projects or programs to be undertaken through these entities, the modalities of utilization of funds on such projects and programs and the monitoring and reporting mechanism.

○ A company may also collaborate with other companies for undertaking projects or programs or CSR activities in such a manner that the CSR Committees of respective companies are in a positions to report separately on such projects or programs in accordance with these rules.

○ The CSR projects or programs or activities undertaken in India only shall amount to CSR Expenditure.

○ The CSR projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act.

○ Companies may build CSR capacities of their own personnel as well as those of their Implementing agencies through institutions with established track records of atleast three financial years but such expenditure (including expenditure on administrative overheads) shall not exceed five percent of total CSR expenditure of the company in one financial year.

○ Contribution of any amount directly or indirectly to any political party under section 182 of the Act, shall not be considered as CSR activity.

○ Companies while undertaking CSR activities shall not contravene any other prevailing laws of the land.

○ One-off events such as marathons/ awards/ charitable contribution/ advertisement/ sponsorships of TV programmes etc. do not be qualified as part of CSR expenditure.

○ Expenses incurred by companies for the fulfillment of any Act/ Statute of regulations (such as Labour Laws, Land Acquisition Act etc.) are not count as CSR expenditure under the Companies Act.

CSR Activities [Rule 4]:

(1) The CSR activities shall be undertaken by the company, as per its stated CSR Policy, as projects or programs or activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business.

(2) The Board of a company may decide to undertake its CSR activities approved by the CSR Committee, through-

- a company established under section 8 of the Act or a registered trust or a registered society, established by the company, either singly or along with any other company, or

- a company established under section 8 of the Act or a registered trust or a registered society, established by the Central Government or State Government or any entity established under an Act of
Parliament or a State legislature:

Provided that if, the Board of a company decides to undertake its CSR activities through a company established under section 8 of the Act or a registered trust or a registered society, other than those specified in this sub-rule, such company or trust or society shall have an established track record of three years in undertaking similar programs or projects; and the company has specified the projects or programs to be undertaken, the modalities of utilisation of funds of such projects and programs and the monitoring and reporting mechanism.

(3) A company may also collaborate with other companies for undertaking projects or programs or CSR activities in such a manner that the CSR Committees of respective companies are in a position to report separately on such projects or programs in accordance with these rules.

(4) Subject to provisions of sub-section (5) of section 135 of the Act, the CSR projects or programs or activities undertaken in India only shall amount to CSR Expenditure.

(5) The CSR projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act.

(6) Companies may build CSR capacities of their own personnel as well as those of their Implementing agencies through Institutions with established track records of at least three financial years but such expenditure shall not exceed five per cent of total CSR expenditure of the company in one financial year.

(7) Contribution of any amount directly or indirectly to any political party under section 182 of the Act, shall not be considered as CSR activity.

### List of CSR Activities

Schedule VII of the Companies Act, 2013 specifies the activities which may be included by companies in their Corporate Social Responsibility Policies. The entries in the said Schedule VII must be interpreted liberally so as to capture the essence of the subjects enumerated in the said Schedule. The items enlisted in the amended Schedule VII of the Act, are broad-based and are intended to cover a wide range of activities as illustratively.

However, in determining CSR activities to be undertaken, preference would need to be given to local areas and the areas around where the company operates.

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<td>ACTIVITIES WHICH MAY BE INCLUDED BY COMPANIES IN THEIR CORPORATE SOCIAL RESPONSIBILITY POLICIES</td>
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<td>Activities relating to:—</td>
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<td>i. eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation and making available safe drinking water;</td>
</tr>
<tr>
<td>ii. promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood</td>
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enhancement projects;

iii. promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;

iv. ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water including contribution to the Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga;

v. protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;

vi. measures for the benefit of armed forces veterans, war widows and their dependents;

vii. training to promote rural sports, nationally recognised sports, paralympic sports and Olympic sports;

viii. contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;

ix. contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;

x. rural development projects;

xi. slum area development.

Explanation: For the purposes of this item, the term 'slum area' shall mean any area declared as such by the Central Government or any State Government or any other competent authority under any law for the time being in force.

**Computation of net profit**

The net worth, turnover and net profits are to be computed in terms of Section 198 of the 2013 Act as per the profit and loss statement prepared by the company in terms of Section 381 (1) (a) and Section 198 of the Companies Act, 2013. Every company will have to report its standalone net profit during a financial year for the purpose of determining whether or not it triggers the threshold criteria as prescribed under Section 135(1) of the Companies Act.

**Disclosure Requirements**

It is mandatory for companies to disclose in Board’s Report, an annual report on CSR. The report of the Board of Directors attached to the financial statements of the Company would also need to include an annual report on the CSR activities of the company in the format prescribed containing following particulars –

- A brief outline of the company’s CSR policy, including overview of projects or programs proposed to be undertaken and a reference to the web-link to the CSR policy and projects or programs.
- The Composition of the CSR Committee.
- Average net profit of the company for last three financial years.
○ Prescribed CSR Expenditure
○ Details of CSR spent during the financial year.
○ In case the company has failed to spend the two per cent of the average net profit of the last three financial years or any part thereof, the company shall provide the reasons for not spending the amount in its Board report.
○ A responsibility statement of the CSR Committee that the implementation and monitoring of CSR Policy, is in compliance with CSR objectives and Policy of the company.

If the company has been unable to spend the minimum required on its CSR initiatives, the reasons for not doing so are to be specified in the Board Report. If a company has a website, the CSR policy and the report containing details of such activities have to be made available on the company’s website for informational purposes.

### CSR Reporting [Rule 8]

(1) The Board's Report of a company covered under these rules pertaining to a financial year commencing on or after the 1st day of April, 2014 shall include an annual report on CSR containing particulars specified in Annexure.

(2) In case of a foreign company, the balance sheet filed under sub-clause (b) of sub-section (1) of section 381 shall contain an Annexure regarding report on CSR.

### Display of CSR activities on its website [Rule 9]

The Board of Directors of the company shall, after taking into account the recommendations of CSR Committee, approve the CSR Policy for the company and disclose contents of such policy in its report and the same shall be displayed on the company’s website, if any, as per the particulars specified in the Annexure:

<table>
<thead>
<tr>
<th>Table - 4</th>
<th>Reporting format of CSR Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Format for the Annual Report on CSR Activities</td>
<td>(To be included in the Board’s Report)</td>
</tr>
<tr>
<td>1. A brief outline of the company’s CSR policy, including overview of projects or programs proposed to be undertaken and a reference to the web-link to the CSR policy and projects Or programs.</td>
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<tr>
<td>2. The Composition of the CSR Committee.</td>
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<tr>
<td>3. Average net profit of the company for last three financial years</td>
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<tr>
<td>4. Prescribed CSR Expenditure (two per cent. Of the amount as in item 3 above)</td>
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<tr>
<td>5. Details of CSR spent during the financial year.</td>
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</table>

(a) Total amount to be spent for the financial year;
(b) Amount unspent, if any;

(c) Manner in which the amount spent during the financial year is detailed below.

<table>
<thead>
<tr>
<th>S.No.</th>
<th>CSR Project or activity identified</th>
<th>Sector in which the Project is covered</th>
<th>Projects or programs (1) Local area or other (2) Specify the State and district where projects or programs was undertaken</th>
<th>Amount outlay (budget) project or programs wise</th>
<th>Amount spent on the projects or programs Sub-heads: (1) Direct expenditure on projects or programs (2) Overheads:</th>
<th>Cumulative expenditure up to the reporting period</th>
<th>Amount spent: Direct or through implementing agency*</th>
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<td>Total</td>
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</tbody>
</table>

* Give details of implementing agency

6. In case the company has failed to spend the two per cent of the average net profit of the last three financial years or any part thereof, the company shall provide the reasons for not spending the amount in its Board report.

7. A responsibility statement of the CSR Committee that the implementation and monitoring of CSR Policy, is in compliance with CSR objectives and Policy of the company.

Sd/-
(Chief Executive Officer or Managing Director or Director)

Sd/-
(Chairman CSR Committee)

Sd/-
(Person specified under clause (d) of sub-section (1) of section 380 of the Act) (wherever applicable)

CORPORATE CITIZENSHIP – BEYOND THE MANDATE OF LAW

Corporate citizenship is a commitment to improve community well-being through voluntary business practices and contribution of corporate resources leading to sustainable growth. Corporate responsibility is achieved when a business adapts CSR well aligned to its business goals and meets or exceeds, the ethical, legal, commercial and public expectations that society has of business.

The term corporate citizenship implies the behaviour, which would maximize a company’s positive impact and minimize the negative impact on its social and physical environment. It means moving from supply driven to
more demand led strategies; keeping in mind the welfare of all stakeholders; more participatory approaches to working with communities; balancing the economic cost and ‘benefits with the social; and finally dealing with processes rather than structures. The ultimate goal is to establish dynamic relationship between the community, business and philanthropic activities so as to complement and supplement each other.

Corporate citizenship is being adopted by more companies who have come to understand the importance of the ethical treatment of stakeholders.

**Tata Steel – A company that also makes steel**

Tata Steel’s Vision strikes a balance between economic value as well as ecological and societal value by aspiring to be "a Global Benchmark in Value Creation and Corporate Citizenship". In the initial years, Tata Steel’s CSR interventions were more as a ‘provider’ to society where the community was given support for its overall needs, both for sustenance and development. Gradually, the shift in approach led to Tata Steel being an ‘enabler’ focusing on building community capacity through training programmes; focusing on providing technical support rather than giving aid. At present, CSR interventions of Tata Steel focus on ‘sustainable development’ to enhance the quality of life of people. It guides the Company in its race to excel in all areas of sustainability. J R D Tata the Chairman of the Tata Group believed that, "to create good working conditions, to pay the best wages to its employees and provide decent housing to its employees are not enough for the industry, the aim of an industry should be to discharge its overall social responsibilities to the community and the society at large, where industry is located."

Guided by this mandate, Tata Steel has for decades uses its skills and resources, to the extent it can reasonably afford, to give back to the community a fair share of the product of its efforts.

It was the first to establish labour welfare practices, even before these were made statutory laws across the world. The Company also instituted an eight-hour workday in 1912, free medical aid in 1915, a Welfare Department in 1917, leave with pay, Workers Provident Fund and Workmen’s Compensation in 1920 and Maternity Benefit for ladies in 1928.

The Company supports and propagates the principles of the United Nations Global Compact as a Founder Member, is a signatory to the Worldsteel Sustainability Charter and supports the Affirmative Action programme of the Confederation of Indian Industry.

Tata Steel’s approach to business has evolved from the concept that the wealth created must be continuously returned to society. The responsibility of combining the three elements of society - social, environmental, and economic - is of utmost importance to the way of life at Tata Steel. Today, Tata Steel’s CSR activities in India encompass the Company’s Steel Works, Iron ore mines and collieries, reaching out to the city of Jamshedpur, its peri-urban areas and over 800 villages in the states of Jharkhand, Odisha and Chhattisgarh. Community involvement is a characteristic of all Tata Steel Group companies around the world. It can take the form of financial support, provision of materials and the involvement of time, skills and enthusiasm of employees. The Group contributes to a very wide range of social, cultural, educational, sporting, charitable and emergency assistance programmes. The Company works in partnership with the Government, national and international development organisations, local NGOs and the community to ensure sustainable development. The Corporate ServicesDivision delivers these responsibilities through several institutionalised bodies:

- Tata Steel Corporate Social Responsibility and Accountability Policy
- Corporate Social Responsibility
- Tata Steel Rural Development Society (TSRDS)
To assess the effectiveness of its social initiatives Tata Steel has innovatively devised a Human Development Index (HDI). In 2012-13, HDI assessment was completed for 230 villages. The Corporate Social Responsibility Advisory Council was also created with the objective that this apex body along with the results of the measurement of HDI will enable the Group to direct its social initiatives better and allocate resources more efficiently.

GLOBAL PRINCIPLES AND GUIDELINES

A comprehensive guidance for companies pertaining to CSR is available in the form of several globally recognised guidelines, frameworks, principles and tools, some of which are discussed below. It must be noted that most of these guidelines relate to the larger concept of sustainability or business responsibility, in keeping with the fact that these concepts are closely aligned globally with the notion of CSR.

UNGC

UNGC is world’s largest corporate citizenship initiative with the objective to mainstream the adoption of sustainable and socially responsible policies by businesses around the world. The 10 principles of the UN Global Compact have been derived from various UN conventions such as the Universal Declaration of Human Rights, ILO’s Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on environment and development, and the UN Convention against Corruption. These principles cover four broad areas:

- Human rights (support and respect the protection of international human rights and ensure that business is not complicit with human rights abuses)
- Labour rights (uphold the freedom of association and effective recognition of the right to collective bargaining, elimination of all forms of forced and compulsory labour, effective abolition of child labour and elimination of description in respect of employment and occupation)
- Environment (support a precautionary approach to environmental challenges, undertake initiatives to promote greater environmental responsibility and encourage the development of environmental friendly technology)
• Governance (work against corruption in all forms, including bribery and extortion).

The UN Guiding Principles on Business and Human Rights

The UN guiding principles provide assistance to states and businesses to fulfil their existing obligations towards respecting and protecting human rights and fundamental freedoms and comply with the existing laws. These principles act as global standards for addressing the risk of human rights violation related to business activity. In circumstances when these laws are breached or the guidance is not adhered to, suitable remedies have also been recommended. The primary focus is on the protection of human rights by both, the state and the business enterprises, and the principles broadly outline the manner in which the framework can be implemented.

OECD Guidelines: Multinational enterprises

OECD Guidelines for multinational enterprises elaborate on the principles and standards for responsible business conduct for multinational corporations. These guidelines were recently updated in 2011. They cover areas such as employment, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition and taxation. They contain defined standards for socially and environmentally responsible corporate behaviour, and also provide procedures for resolving disputes between corporations and communities or individuals adversely impacted by business activities.

Institute of Social and Ethical Accountability: AccountAbility’s AA1000 series of standards

This is a series of standards which enable organisations to become accountable, responsible and sustainable. It consists of the (i) AA1000 accountability principles (AP) standard (ii) AA1000 assurance standard (AS) (iii) AA1000 stakeholder engagement (SE) standard. Since these standards have been formulated through a multi-stakeholder consultation process, they ensure that those impacted (that is, enterprises, governments and civil societies) stand to gain. The Vodafone Group Plc has adopted the AA1000AP standard by focusing on three broad areas: (i) inclusivity (stakeholder engagement to develop and implement a strategic approach to sustainability) (ii) materiality (assess the management effort required for each material issue and determine the content of sustainability reports) (iii) responsiveness (respond with solutions to material issues and challenges).

Social Accountability International (SAI): SA 8000 Standard

This is one of the world’s first auditable social certification standard. It is based on ILO, UN and national law conventions, and adopts a management system approach in order to ensure that companies that adopt this approach also comply with it. This standard ensures the protection of basic human rights of workers. The nine basic elements of this standard include (i) child labour (ii) forced and compulsory labour (iii) health and safety (iv) freedom of association and the right to collective bargaining (v) discrimination (vi) disciplinary practices (vii) working hours (viii) remuneration (ix) management systems. According to SAAS, there are 695 facilities in India that have been accredited with this standard. Out of these, Aditya Birla Chemicals (India) Limited, Bhilai Steel Plant Steel Authority of India Limited, Birla tyres, Dr Reddy’s Laboratories Limited and Reliance Infrastructure Limited figure prominently in the list of certified facilities within India.

ISO 26000: Social responsibility

ISO 26000 is the international standard giving guidance on social responsibility and is intended for use by organizations of all types both public and private sectors, in developed and developing countries. It provides guidance on principles of social responsibility, the core subjects and issues pertaining to social responsibility and on ways to integrate socially responsible behaviour into existing organizational strategies, systems, practices and processes.

This is a guidance tool provided by the ISO which enables organisations to understand the meaning and
significance of social responsibility. It is important to note that this is not a certification but only a guiding tool. Hence, organisations which comply with these standards are self-certified. It covers six core areas of social responsibility, including (i) human rights (ii) labour practices (iii) environment (iv) fair operating practices (v) consumer issues (vi) community involvement and development. This ensures a holistic approach to the concept of social responsibility and sustainable development.

It intends to assist organizations in contributing to sustainable development. It is intended to encourage them to go beyond legal compliance, recognizing that compliance with law is a fundamental duty of any organization and an essential part of their social responsibility. It is intended to promote common understanding in the field of social responsibility, and to complement other instruments and initiatives for social responsibility, not to replace them.

ISO 26000 is not a management system standard. It is not intended or appropriate for certification purposes or regulatory or contractual use.

**Global Compact Self-Assessment Tool**

The Global Compact Self Assessment Tool is an easy-to-use guide designed for use by companies of all sizes and across sectors committed to upholding the social and environmental standards within their respective operations. The tool consists of 45 questions with a set of three to nine indicators for each question. It consists of a ‘management section’ and four other sections, including human rights, labour, environment and anti-corruption that relate to the principles of the UN Global Compact. The tool is in line with the UN Guiding Principles on Business and Human Rights. For a small company, this tool acts as a measure of the company’s performance in all areas of the UN Global Compact and how well these issues are managed. For a large organisation, this tool helps to continuously improve existing policies and systems, engage subsidiaries, suppliers or other stakeholders, and improves internal and external reporting.

**TRIPLE BOTTOM LINE APPROACH OF CSR**

Within the broader concept of corporate social responsibility, the concept of Triple Bottom Line (TBL) is gaining significance and becoming popular amongst corporates. Coined in 1997 by John Ellington, noted management consultant, the concept of TBL is based on the premise that business entities have more to do than make just profits for the owners of the capital, only bottom line people understand. “People, Planet and Profit” is used to succinctly describe the triple bottom lines. “People” (Human Capital) pertains to fair and beneficial business practices toward labor and the community and region in which a corporation conducts its business. “Planet” (Natural Capital) refers to sustainable environmental practices. It is the lasting economic impact the organization has on its economic environment A TBL company endeavors to benefit the natural order as much as possible or at the least do no harm and curtails environmental impact. “Profit” is the bottom line shared by all commerce.
The need to apply the concept of TBL is caused due to—

(a) Increased consumer sensitivity to corporate social behaviour
(b) Growing demands for transparency from shareholders/stakeholders
(c) Increased environmental regulation
(d) Legal costs of compliances and defaults
(e) Concerns over global warming
(f) Increased social awareness
(g) Awareness about and willingness for respecting human rights
(h) Media’s attention to social issues
(i) Growing corporate participation in social upliftment

While profitability is a pure economic bottom line, social and environmental bottom lines are semi or non-economic in nature so far as revenue generation is concerned but it has certainly a positive impact on long term value that an enterprise commands.

But discharge of social responsibilities by corporates is a subjective matter as it cannot be measured with reasonable accuracy.

Gaining Recognition: The current generation people are well aware of what goes on around them. People today know a lot about environment, how it affects them, how things we do affects the environment in turn. For the aware and conscientious consumers today, it is important that they buy products that do not harm the environment. They only like to deal with companies that believe and do things for the greater good of planet earth.

SUSTAINABILITY REPORTING

The concept of sustainability reporting is of recent origin. Conventionally financial accounting was the tool that aided management control. Then, management accounting has emerged separately with focus on generating information for management planning, control and decision-making. In the recent years, with emphasis being placed on the ways in which companies match their resources to the needs of the marketplace, it has given rise to the concept of corporate performance management and measurement. The new approach is an integrated one seeking to link strategic management, management accounting and reporting. The reporting contemplated here covers the whole information communication process comprising internal and external stakeholders. Sustainability reporting is a part of the new approach.

Sustainability reporting is a process for publicly disclosing an organization’s economic, environmental, and social performance. Many companies find that financial reporting alone no longer satisfies the needs of shareholders, customers, communities and other stakeholders for information about overall organizational performance. Through sustainability reporting, organizations report on progress against performance goals not only for economic achievements, but for environmental protection and social well-being.

John Elkington has coined the term ‘triple bottom line’ to describe social, environmental and financial accounting. A sustainability report comprises information on how a company, proactively and beyond regulations, acts responsibly towards the environment around it and works towards equitable and fair business practices and brings to life products and services with lower impacts on the natural environment. Such a report describes how a company has implemented a greener supply chain, has engaged with local
communities, is helping tackle climate-change issues, or is “innovating for the poor”. Best-in-class reports mention where raw material labour are sourced from, and openly discuss sustainability issues at hand (e.g. diversity in the workforce, overall environmental footprint, safety performance, labour conditions in the supply-chain), along with the associated “remediation steps”. Some of the best reporting organisations benchmark their sustainability performance against global peers.

A sustainability report is a report published by a company or organization about the economic, environmental and social impacts caused by its everyday activities. A sustainability report also presents the organization's values and governance model, and demonstrates the link between its strategy and its commitment to a sustainable global economy.

Sustainability reporting can be considered as synonymous with other terms for non-financial reporting; triple bottom line reporting, corporate social responsibility (CSR) reporting, and more. It is also an intrinsic element of integrated reporting; a more recent development that combines the analysis of financial and non-financial performance.

### Benefits of sustainability reporting

Sustainability reporting can help organizations to measure, understand and communicate their economic, environmental, social and governance performance, and then set goals, and manage change more effectively. A sustainability report is the key platform for communicating sustainability performance and impacts – whether positive or negative.

- **Internal benefits of sustainability reporting for companies and organizations can include:**
  - Increased understanding of risks and opportunities
  - Emphasizing the link between financial and non-financial performance
  - Influencing long term management strategy and policy, and business plans
  - Streamlining processes, reducing costs and improving efficiency
  - Benchmarking and assessing sustainability performance with respect to laws, norms, codes, performance standards, and voluntary initiatives
  - Avoiding being implicated in publicized environmental, social and governance failures
  - Comparing performance internally, and between organizations and sectors

- **External benefits of sustainability reporting can include:**
  - Mitigating – or reversing – negative environmental, social and governance impacts
  - Improving reputation and brand loyalty
  - Enabling external stakeholders to understand the organization’s true value, and tangible and intangible assets
  - Demonstrating how the organization influences, and is influenced by, expectations about sustainable development

Some of the key drivers of sustainability reporting are-

- **Regulations**: Governments, at most levels have stepped up the pressure on corporations to measure the impact of their operations on the environment. Legislation is becoming more innovative and is covering an ever wider range of activities. The most notable shift has been from voluntary to mandatory
sustainability, monitoring and reporting.

- **Customers**: Public opinion and consumer preferences are a more abstract but powerful factor that exerts considerable influence on companies, particularly those that are consumer oriented. Customers significantly influence a company’s reputation through their purchasing choices and brand.

- **Loyalty**: This factor has led the firms to provide much more information about the products they produce, the suppliers who produce them, and the product’s environmental impact starting from creation to disposal.

- **NGO’s and the media**: Public reaction comes not just from customers but from advocates and the media, who shape public opinion. Advocacy organisations, if ignored or slighted, can damage brand value.

- **Employees**: Those who work for a company bring particular pressure to bear on how their employers behave; they, too, are concerned citizens beyond their corporate roles.

- **Peer pressure from other companies**: Each company is part of an industry, with the peer pressures and alliances that go along with it. Matching industry standards for sustainability reporting can be a factor; particularly for those who operate in the same supply chain and have environmental or social standards they expect of their partners.

- **Companies themselves**: Corporations, as public citizens, feel their own pressure to create a credible sustainability policy, with performance measures to back it up, but with an eye on the bottom line as well. Increasingly, stakeholders are demanding explicit sustainability reporting strategies and a proof of the results.

- **Investors**: Increasingly, investors want to know that companies they have targeted have responsible, sustainable, long-term business approaches. Institutional investors and stock exchange CEOs, for example, have moved to request increased sustainability reporting from listed companies, and environmental, social and corporate governance indices have been established such as the Dow Jones Sustainability Index.

## GLOBAL REPORTING INITIATIVE - SUSTAINABILITY REPORTING FRAMEWORK

As for financial reporting, companies follow a generally accepted reporting framework; Global Reporting Initiative (GRI) has developed a generally accepted framework to simplify report preparation and assessment, helping both reporters and report users gain greater value from sustainability reporting.

Global Reporting Initiative (GRI) is an initiative at the global level to standardize non-financial Reporting (NFR), which the institutions adopt and has become the standard internationally.

GRI is a long-term, multi-stakeholder, international process whose mission is to develop and disseminate globally applicable Sustainability Reporting Guidelines. The aim of the Guidelines is to assist reporting organizations and their stakeholders in articulating and understanding contributions of the reporting organizations to sustainable development.

The GRI Sustainability Reporting Framework is made up of the Sustainability Reporting Guidelines, Sector supplements and Indicator Protocols. Together these are known as the Sustainability Reporting Framework. The GRI Reporting Framework is intended to serve as a generally accepted framework for reporting on an organization’s economic, environmental, and social performance. It is designed for use by organizations of any size, sector, or location. It takes into account the practical considerations faced by a diverse range of
organizations – from small enterprises to those with extensive and geographically dispersed operations.

The Sustainability Reporting Guidelines are the core element of the Reporting Framework. They outline content that is broadly relevant to all organizations regardless of size, sector or location. The Sustainability Reporting Guidelines developed by the Global Reporting Initiative, is a significant system that integrates sustainability issues into a frame of reporting.

**Global Reporting Initiative - Sustainability Reporting Guidelines**

An ever-increasing number of companies and other organizations want to make their operations sustainable. Moreover, expectations that long-term profitability should go hand-in-hand with social justice and protecting the environment are gaining ground. These expectations are only set to increase and intensify as the need to move to a truly sustainable economy is understood by companies’ and organizations’ financiers, customers and other stakeholders. Sustainability reporting helps organizations to set goals, measure performance, and manage change in order to make their operations more sustainable.

In this context, the Global Reporting Initiative (GRI) launched the fourth generation of its sustainability reporting guidelines: the GRI G4 Sustainability Guidelines (the Guidelines) in 2013. The aim of G4, is to help reporters prepare sustainability reports that matter, contain valuable information about the organization’s most critical sustainability-related issues, and make such sustainability reporting standard practice.

G4 is applicable to all organizations, large and small, across the world. The Guidelines are now presented in two parts to facilitate the identification of reporting requirements and related guidance. It consist of following two parts:

- **Part 1 - Reporting Principles and Standard Disclosures**: It contains the reporting principles and standard disclosures and also sets out the criteria to be applied by an organization to prepare its sustainability report in accordance with the Guidelines.

- **Part 2 - Implementation Manual**: It contains reporting and interpretative guidance that an organization should consult when preparing its sustainability report.

The Guidelines are designed to align and harmonize as much as possible with other internationally recognized standards. The Guidelines provide links with the United Nations Global Compact’s Ten Principles, 2000; the OECD’s Guidelines for Multinational Enterprises, 2011; and the UN’s Guiding Principles on Business and Human Rights, 2011.

**Reporting Principles**

The Reporting Principles are fundamental to achieving transparency in sustainability reporting and therefore should be applied by all organizations when preparing a sustainability report. The Implementation Manual outlines the required process to be followed by an organization in making decisions consistent with the Reporting Principles.

The Principles are divided into two groups:

(a) **Principles for defining report content**: The Principles for Defining Report Content describe the process to be applied to identify what content the report should cover by considering the organization’s activities, impacts, and the substantive expectations and interests of its stakeholders. These Principles are designed to be used in combination to define the report content.

(b) **Principles for Defining Report Quality**: The Principles for Defining Report Quality guide on ensuring the quality of information in the sustainability report, including its proper presentation. The quality of the
information is important to enable stakeholders to make sound and reasonable assessments of performance, and take appropriate actions. Decisions related to the process of preparing information in a report should be consistent with these Principles. All of these Principles are fundamental to achieving transparency.

UNITED NATIONS GLOBAL COMPACT’S TEN PRINCIPLES, 2000

Corporate sustainability starts with a company’s value system and a principled approach to doing business. This means operating in ways that, at a minimum, meet fundamental responsibilities in the areas of human rights, labour, environment and anti-corruption. Responsible businesses enact the same values and principles wherever they have a presence, and know that good practices in one area do not offset harm in another.

The UN Global Compact is a strategic policy initiative for businesses that are committed to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption. By incorporating the Global Compact principles into strategies, policies and procedures, and establishing a culture of integrity, companies are not only upholding their basic responsibilities to people and planet, but also setting the stage for long-term success. The UN Global Compact’s Ten Principles are derived from: the Universal Declaration of Human Rights, the International Labour Organization’s Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption.

Ten Principles

- Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and
- Principle 2: make sure that they are not complicit in human rights abuses.
- Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
- Principle 4: the elimination of all forms of forced and compulsory labour;
- Principle 5: the effective abolition of child labour; and
- Principle 6: the elimination of discrimination in respect of employment and occupation.
- Principle 7: Businesses should support a precautionary approach to environmental challenges;
- Principle 8: undertake initiatives to promote greater environmental responsibility; and
- Principle 9: encourage the development and diffusion of environmentally friendly technologies.
- Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.

UNITED NATIONS GLOBAL COMPACT’S COMMUNICATION ON PROGRESS

UN Global Compact incorporates a transparency and accountability policy known as the Communication on Progress (COP). The Communication on Progress (COP) is an annual disclosure to stakeholders on progress made in implementing the ten principles of the UN Global Compact in the areas of human rights, labour, environment and anti-corruption, and in supporting broader UN development goals. The COP is posted on the Global Compact website by business participants. Failure to issue a COP will change a participant’s status to non-communicating and can eventually lead to the expulsion of the participant.
Purpose:

- The COP helps drive continuous sustainability performance improvement within the company. The library of COPs at the UN Global Compact website represents the largest repository of corporate practices in sustainability.
- The COP provides investors with sustainability performance information of companies, thus allowing for a more effective integration of environmental, social and governance (ESG) considerations in their investments and resulting in a more effective allocation of capital.
- The COP is an important demonstration of a company’s commitment to transparency and accountability and it serves as an effective tool for multi-stakeholder dialogue.

Joining the Global Compact is a widely visible commitment to the ten principles. A company that signs-on to the Global Compact specifically commits itself to:

- set in motion changes to business operations so that the Global Compact and its principles become part of management, strategy, culture, and day-to-day operations;
- publish in its annual report or similar public corporate report (e.g. sustainability report) a description of the ways in which it is supporting the Global Compact and its principles (Communication on Progress),
- publicly advocate the Global Compact and its principles via communications vehicles such as press releases, speeches, etc.

Ideally, COPs should be integrated into a participant’s existing communication with stakeholders, such as an annual or sustainability report. However, in case a participant does not publish such reports, a COP can be a stand-alone report that is made available for stakeholders through other public communication channels (e.g. websites, newsletters, intranets, company notice boards, included with payroll, etc.). COPs should be issued in the company’s working language and, if the company determines a need, in additional languages.

Participants are asked to supply a URL link to their COP and to upload the COP itself (as a PDF, Powerpoint, or word document) to the Global Compact website in order to meet the COP submission requirement.

While there is no strict format for a COP, in order to be considered complete, it must contain:

- a statement of continued support for the Global Compact in the opening letter, statement or message from the company’s top executive;
- description of practical actions that participants have taken to implement the Global Compact principles since their last COP (or since they joined the Global Compact);
- a measurement of outcomes or expected outcomes using, as much as possible, indicators or metrics such as, for example, the Global Reporting Initiative Guidelines.

Initial COP submission - New participants must submit their first COP one year after joining the initiative.

Subsequent COP submissions - Existing participants are required to submit their COPs one year after the last submission. For example, if the last submission took place on 1 March 2013, the next COP will be due on 1 March 2014.

If a company fails to meet a COP submission deadline, it will be marked as “non-communicating”. Companies that have been non-communicating for longer than 12 months will be expelled from the Global Compact.
Grace period – There are two options to request a deadline modification:

- Grace Period Letter (grants an additional 90 days); or Adjustment Request (one-time only deferral of up to 11 months to adjust the reporting cycle)

A Grace Period Letter extends the deadline by 90 days. Unlike the Adjustment Request, it can be used more than once, as long as it is not used consecutively. A Grace Period letter explains that the company is requesting additional time to submit its COP and explains the reason behind the request. An Adjustment Request explains what the company's standard reporting cycles are, in order to align the COP submission deadline with them.

**SUSTAINABILITY INDICES**

(A) DOW-JONES SUSTAINABILITY INDEX

The Dow Jones Sustainability Indices are the first global indices tracking the financial performance of the leading sustainability-driven companies worldwide, it was launched in 1999.

The Dow Jones Sustainability World Index (DJSI World) comprises more than 300 companies that represent the top 10% of the leading sustainability companies out of the biggest 2500 companies in the Dow Jones World Index.

In addition to the composite DJSI World, there are six specialized subset indexes excluding alcohol, ex gambling, ex tobacco, ex armaments & firearms, ex alcohol, tobacco, gambling, armaments & firearms indexes, and ex alcohol, tobacco, gambling armaments & firearms, and adult entertainment.

(B) ENVIRONMENT, SOCIAL, GOVERNANCE (ESG) INDEX

ESG describes the environmental, social and corporate governance issues that investors are considering in the context of corporate behaviour. Integration of ESG refers to the active investment management processes that include an analysis of environmental, social, and corporate governance risks and opportunities and sustainability aspects of company performance evaluation.

The ESG index employs a unique and innovative methodology that quantifies a company's ESG practices and translates them into a scoring system which is then used to rank each company against its peers in the market. Its quantitative scoring system offers investors complete transparency on Environmental, Social & governance issues of a company.

Key Performance Indicators:

- Environment - Energy use and efficiency, Greenhouse gas emissions, Water use, Use of ecosystem services – impact & dependence and Innovation in environment friendly products and services.
- Social - Employees, Poverty and community impact and Supply chain management
- Governance - Codes of conduct and business principles, accountability, transparency and disclosure and Implementation – quality and consistency.

(C) STANDARD & POOR’S ESG INDIA INDEX

Standard & Poor’s ESG India index provides investors with exposure to a liquid and tradable index of 50 of the best performing stocks in the Indian market as measured by environmental, social, and governance parameters. The index employs a unique and innovative methodology that quantifies a company’s ESG practices and translates them into a scoring system which is then used to rank each company against their peers in the Indian market. Its quantitative scoring system offers investors complete transparency.
The creation of the index involves a two step process, the first of which uses a multi-layered approach to determine an ‘ESG’ score for each company. The second step determines the weighting of the index by score. Index constituents are derived from the top 500 Indian companies by total market capitalizations that are listed on National Stock Exchange of India Ltd. (NSE). These stocks are then subjected to a screening process which yields a score based on a company’s ESG disclosure practices in the public domain.

**SUSTAINABILITY REPORTING FRAMEWORK IN INDIA**

The Ministry of Corporate Affairs (MCA) recommends sustainability reporting in India. Considering the importance of sustainability in businesses, MCA launched Corporate Social Responsibility Voluntary Guidelines in 2009. This voluntary CSR Policy addresses six core elements – Care for all Stakeholders, Ethical functioning, Respect for Workers’ Rights and Welfare, Respect for Human Rights, Respect for Environment and Activities for Social and Inclusive Development. To take this further, in 2011 MCA issued ‘National Voluntary Guidelines on Social, Environmental and Economical Responsibilities of Business’ which encourages reporting on environment, social and governance issues.

In line with the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business and considering the larger interest of public disclosure regarding steps taken by listed entities from an Environmental, Social and Governance (“ESG”) perspective, SEBI decided to mandate inclusion of Business Responsibility Reports (“BR reports”) as part of the Annual Reports for listed entities.

**National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, 2011**

These guidelines contain comprehensive principles to be adopted by companies as part of their business practices and a structured business responsibility reporting format requiring certain specified disclosures, demonstrating the steps taken by companies to implement the said principles. The National Voluntary Guidelines are articulated in the form of 9 broad principles which include the business responsibilities of a corporate with regard to: ethics, transparency and accountability; product/service lifecycle; employee well-being; upholding the interests of all stakeholder, especially those who are disadvantaged, vulnerable and marginalized; human rights; environment; influencing public and regulatory policy; inclusive growth & equitable development; customers.

One of the critical aspects of Responsible Business practices is that businesses should not only be responsible but they should also be seen as socially, economically and environmentally responsible. The National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business framework has 36 parameters reflecting nine key principles related to responsible business practices. The Guidelines encompassing nine Principles and related Core Elements identify the areas where responsible practices need to be adopted and the Reporting Framework provides a standard disclosure template which can be used by businesses to report on their performance in these areas.

**Principles**

The principles as recommended by the National Voluntary Guidelines are summarized below:

**Principle 1**

Businesses should conduct and govern themselves with Ethics, Transparency and Accountability

**Principle 2**

Businesses should provide goods and services that are safe and contribute to sustainability throughout their
Lesson 16  ■  Sustainability and Corporate Social Responsibility  495

life cycle

**Principle 3**
Businesses should promote the well being of all employees

**Principle 4**
Businesses should respect the interests of, and be responsive towards all stakeholders, especially those who are disadvantaged, vulnerable and marginalized.

**Principle 5**
Businesses should respect and promote human rights

**Principle 6**
Business should respect, protect, and make efforts to restore the environment.

**Principle 7**
Businesses, when engaged in influencing public and regulatory policy, should do so in a responsible manner

**Principle 8**
Businesses should support inclusive growth and equitable development

**Principle 9**
Businesses should engage with and provide value to their customers and consumers in a responsible manner

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**BUSINESS RESPONSIBILITY REPORT**

In line with the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business and considering the larger interest of public disclosure regarding steps taken by listed entities from an Environmental, Social and Governance (“ESG”) perspective, SEBI decided to mandate inclusion of Business Responsibility Reports (“BR reports”) as part of the Annual Reports for listed entities. The detail of framework of Business responsibility report is discussed in Lesson 15 –Corporate Sustainability reporting Frameworks.

SEBI in its (Listing Obligations and Disclosure Requirements) Regulations, 2015 has mandated the requirement of submission of BRR for top 500 listed entities describing initiative taken by them from an environmental, social and governance perspective in the prescribed format [Regulation 34(2)(f)].

Business Responsibility Report is a disclosure of adoption of responsible business practices by a listed company to all its stakeholders. This is important considering the fact that these companies have accessed funds from the public, have an element of public interest involved, and are obligated to make exhaustive disclosures on a regular basis.

SEBI has prescribed a format for ‘Business Responsibility Report’. It contains a standardized format for companies to report the actions undertaken by them towards adoption of responsible business practices. Business Responsibility Report has been designed to provide basic information about the company, information related to its performance and processes, and information on principles and core elements of the Business Responsibility Reporting. The prescribed format of a Business Responsibility Report also provides
a set of generic reasons which the company can use for explaining their inability to adopt the business responsibility policy. Further, Business Responsibility Report has been designed as a tool to help companies understand the principles and core elements of responsible business practices and start implementing improvements which reflect their adoption in the manner the company undertakes its business.

The BRR framework is divided into five sections:

(a) **Section A:** General Information about the Organisation – Industry Sector, Products & Services, Markets, other general information

(b) **Section B:** Financial Details of the Organisation – Paid up capital, Turnover, Profits, CSR (Corporate Social Responsibility) spend.

(c) **Section C:** Other Details – BR initiatives at Subsidiaries and Supply-chain Partners

(d) **Section D:** BR Information – Structure, Governance & Policies for Business Responsibility

(e) **Section E:** Principle-wise Performance – Indicators to assess performance on the 9 Business Responsibility principles as envisaged by the National Voluntary Guidelines (NVGs)

**Business Responsibility Report – Suggested Framework**

**Section A: General Information about the Company**

1. Corporate Identity Number (CIN) of the Company

2. Name of the Company

3. Registered address

4. Website

5. E-mail id

6. Financial Year reported

7. Sector(s) that the Company is engaged in (industrial activity code-wise)

8. List three key products/services that the Company manufactures/provides (as in balance sheet)

9. Total number of locations where business activity is undertaken by the Company
   (i) Number of International Locations (Provide details of major 5)
   (ii) Number of National Locations

10. Markets served by the Company – Local/State/National/International/

**Section B: Financial Details of the Company**

1. Paid up Capital (INR)

2. Total Turnover (INR)

3. Total profit after taxes (INR)

4. Total Spending on Corporate Social Responsibility (CSR) as percentage of profit after tax (%)

5. List of activities in which expenditure in 4 above has been incurred:-
   a.
   b.
c.

**Section C: Other Details**

1. Does the Company have any Subsidiary Company/Companies?
2. Do the Subsidiary Company/Companies participate in the BR Initiatives of the parent company? If yes, then indicate the number of such subsidiary company(s)
3. Do any other entity/entities (e.g. suppliers, distributors etc.) that the Company does business with, participate in the BR initiatives of the Company? If yes, then indicate the percentage of such entity/entities? [Less than 30%, 30-60%, More than 60%]

**Section D: BR Information**

1. Details of Director/Directors responsible for BR

   (a) Details of the Director/Director responsible for implementation of the BR policy/policies
   • DIN Number
   • Name
   • Designation

   (b) Details of the BR head

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Particulars</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>DIN Number if applicable</td>
<td></td>
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<tr>
<td>2</td>
<td>Name</td>
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<tr>
<td>3</td>
<td>Designation</td>
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<tr>
<td>4</td>
<td>Telephone Number</td>
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<tr>
<td>5</td>
<td>e-mail id</td>
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</tbody>
</table>

(2) Principle-wise (as per NVGs) BR Policy/policies (Reply in Y/N)

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Questions</th>
<th>P1</th>
<th>P2</th>
<th>P3</th>
<th>P4</th>
<th>P5</th>
<th>P6</th>
<th>P7</th>
<th>P8</th>
<th>P9</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>Do you have a policy/policies for....</td>
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<td>2</td>
<td>Has the policy being formulated in consultation with the relevant stakeholders</td>
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<td>3</td>
<td>Does the policy conform to any national/international standards. If yes, specify? (50 words)</td>
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<td>4</td>
<td>Has the policy being approved by the Board? If yes, has it been signed by MD/owner/CEO/ Appropriate Board Directors</td>
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<td>S.No.</td>
<td>Questions</td>
<td>P1</td>
<td>P2</td>
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<td>P4</td>
<td>P5</td>
<td>P6</td>
<td>P7</td>
<td>P8</td>
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<td>5</td>
<td>Does the company have a specified committee of the Board/Official to oversee the implementation of the policy?</td>
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<td>6</td>
<td>Indicate the link for the policy to be viewed online?</td>
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<td>7</td>
<td>Has the policy been formally communicated to all relevant internal and external stakeholders?</td>
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<td>8</td>
<td>Does the company have in-house structure to implement the policy/policies?</td>
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<td>9</td>
<td>Does the company have grievance redressal mechanism related to the policy/policies to address stakeholders’ grievances related to the policy/policies?</td>
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<td>10</td>
<td>Has the company carried out independent audit/evaluation of the working of this policy by an internal or external agency?</td>
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</tbody>
</table>

(2a). If answer to S.No. 1 against any principle, id `No’, please explain why; (Tick upto 2 options)

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Questions</th>
<th>P1</th>
<th>P2</th>
<th>P3</th>
<th>P4</th>
<th>P5</th>
<th>P6</th>
<th>P7</th>
<th>P8</th>
<th>P9</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>The company has not understood the Principles</td>
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<td></td>
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<td>2</td>
<td>The company is not at a stage where it finds itself in a position to formulate and implement the policies on specified principles.</td>
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<td>3</td>
<td>The company does not have financial or manpower resources available for the task</td>
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<td>4</td>
<td>It is planned to be done within the next 6 months</td>
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<td>5</td>
<td>It is planned to be done within the next 1 year</td>
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<tr>
<td>6</td>
<td>Any other reason (please specify)</td>
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</table>

3. Governance related to BR

- Indicate the frequency with which the Board of Directors, Committee of the Board or CEO to assess the BR performance of the Company. Within 3 months, 3-6 months, Annually, More than 1 year
- Does the Company publish a BR or a Sustainability Report? What is the hyperlink for viewing this report? How frequently it is published?

Section E: Principle-wise performance

Principle 1
Lesson 16 ■ Sustainability and Corporate Social Responsibility

1. Does the policy relating to ethics, bribery and corruption cover only the company? Yes/ No. Does it extend to the Group/Joint Ventures/ Suppliers/Contractors/NGOs /Others?

2. How many stakeholder complaints have been received in the past financial year and what percentage was satisfactorily resolved by the management? If so, provide details thereof, in about 50 words or so.

Principle 2

1. List up to 3 of your products or services whose design has incorporated social or environmental concerns, risks and/or opportunities.
   i.
   ii.
   iii.

2. For each such product, provide the following details in respect of resource use (energy, water, raw material etc.) per unit of product(optional):
   i. Reduction during sourcing/production/ distribution achieved since the previous year throughout the value chain?
   ii. Reduction during usage by consumers (energy, water) has been achieved since the previous year?

3. Does the company have procedures in place for sustainable sourcing (including transportation)?
   i. If yes, what percentage of your inputs was sourced sustainably? Also, provide details thereof, in about 50 words or so.

4. Has the company taken any steps to procure goods and services from local & small producers, including communities surrounding their place of work?
   If yes, what steps have been taken to improve their capacity and capability of local and small vendors? P

5. Does the company have a mechanism to recycle products and waste? If yes what is the percentage of recycling of products and waste (separately as <5%, 5-10%, >10%). Also, provide details thereof, in about 50 words or so.

Principle 3

1. Please indicate the Total number of employees.

2. Please indicate the Total number of employees hired on temporary/contractual/casual basis.

3. Please indicate the Number of permanent women employees.

4. Please indicate the Number of permanent employees with disabilities

5. Do you have an employee association that is recognized by management.

6. What percentage of your permanent employees is members of this recognized employee association?

7. Please indicate the Number of complaints relating to child labour, forced labour, involuntary labour,
sexual harassment in the last financial year and pending, as on the end of the financial year.

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Category</th>
<th>No. of complaints filed during the financial year</th>
<th>No. of complaints pending as on end of this the financial year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Child labour/forced labour/involuntary labour</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>Sexual harassment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>Discriminatory employment</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

8. What percentage of your under mentioned employees were given safety & skill up-gradation training in the last year?
   - Permanent Employees
   - Permanent Women Employees
   - Casual/Temporary/Contractual Employees
   - Employees with Disabilities

**Principle 4**

1. Has the company mapped its internal and external stakeholders? Yes/No

2. Out of the above, has the company identified the disadvantaged, vulnerable & marginalized stakeholders.

3. Are there any special initiatives taken by the company to engage with the disadvantaged, vulnerable and marginalized stakeholders. If so, provide details thereof, in about 50 words or so.

**Principle 5**

1. Does the policy of the company on human rights cover only the company or extend to the Group/Joint Ventures/Suppliers/Contractors/NGOs/Others?

2. How many stakeholder complaints have been received in the past financial year and what percent was satisfactorily resolved by the management?

**Principle 6**

1. Does the policy related to Principle 6 cover only the company or extends to the Group/Joint Ventures/Suppliers/Contractors/NGOs/others.

2. Does the company have strategies/initiatives to address global environmental issues such as climate change, global warming, etc? Y/N. If yes, please give hyperlink for webpage etc.

3. Does the company identify and assess potential environmental risks? Y/N

4. Does the company have any project related to Clean Development Mechanism? If so, provide details thereof, in about 50 words or so. Also, if Yes, whether any environmental compliance report is filed?

5. Has the company undertaken any other initiatives on – clean technology, energy efficiency, renewable energy, etc. Y/N. If yes, please give hyperlink for webpage etc.
6. Are the Emissions/Waste generated by the company within the permissible limits given by CPCB/SPCB for the financial year being reported?

7. Number of show cause/legal notices received from CPCB/SPCB which are pending (i.e. not resolved to satisfaction) as on end of Financial Year.

**Principle 7**

1. Is your company a member of any trade and chamber or association? If Yes, Name only those major ones that your business deals with:
   a.
   b.
   c.
   d.

2. Have you advocated/lobbied through above associations for the advancement or improvement of public good? Yes/No; if yes specify the broad areas (drop box: Governance and Administration, Economic Reforms, Inclusive Development Policies, Energy security, Water, Food Security, Sustainable Business Principles, Others)

**Principle 8**

1. Does the company have specified programmes/initiatives/projects in pursuit of the policy related to Principle 8? If yes details thereof.

2. Are the programmes/projects undertaken through in-house team/own foundation/external NGO/government structures/any other organization?

3. Have you done any impact assessment of your initiative?

4. What is your company's direct contribution to community development projects- Amount in INR and the details of the projects undertaken.

5. Have you taken steps to ensure that this community development initiative is successfully adopted by the community? Please explain in 50 words, or so.

**Principle 9**

1. What percentage of customer complaints/consumer cases are pending as on the end of financial year.

2. Does the company display product information on the product label, over and above what is mandated as per local laws? Yes/No/N.A./Remarks(additional information)

3. Is there any case filed by any stakeholder against the company regarding unfair trade practices, irresponsible advertising and/or anti-competitive behaviour during the last five years and pending as on end of financial year. If so, provide details thereof, in about 50 words or so.

4. Did your company carry out any consumer survey/consumer satisfaction trends?

**CHALLENGES IN MAINSTREAMING SUSTAINABILITY REPORTING**

Since the Sustainability Reporting is relatively a new concept, many organizations find it difficult to prepare sustainability. Following may be considered as the challenges in mainstreaming sustainability reporting:

1. **Government Encouragement**: In many jurisdictions, there are no guidelines on sustainability
reporting to encourage the corporate sector. While on the other hand, there are voluntary as well as mandatory guidelines from regulators for reporting on Sustainability aspects like in India we have SEBI framework of Business Responsibility Report. In South Africa, listed companies are required to prepare Integrated Report which is one step ahead of sustainability reporting. It is the need of the hour, that governments should encourage the corporate in their jurisdiction to adopt the sustainability reporting as a measure of good corporate governance.

2. **Awareness:** Lack of awareness about the emerging concept of sustainability reporting is also a major challenge which the government and corporate governance bodies need to address by arranging the sustainability awareness programme for the Professionals, Board of Directors and Management in the corporate sector, as these are the persons who will drive sustainability reporting initiative for an organisation. The government/regulators should organize such awareness programme jointly with the experts in the field of Sustainability Reporting.

3. **Expertise Knowledge:** Sustainability Reporting is relatively a new concept in many jurisdictions and organization found it very difficult to prepare a sustainability report in the absence of expert guidance on the subject. The Sustainability Reporting concept is emerging as a good tool to showcase the corporate governance practices of an organisation and this area demand professionals having expert knowledge of sustainability reporting. The professional bodies in various jurisdictions should impart the expert knowledge of sustainability reporting to their members to develop a good cadre of experts in this emerging area of sustainability reporting.

4. **Investor Behaviour:** It is a recognized principle that investors should consider the Environmental, Social and Governance (ESG) issues while making investment decisions. There are specific regulators guidelines for the institutional investor to be vigilant on voting aspects and be concerned about the governance practices of the companies in which they invest. However, the investor behaviour may vary from company to company and sometimes they invest in companies without considering the ESG issues either due to lack of awareness on ESG issues or some other business reasons. It should be made a practice that the investor fund flow to those organization following the good governance including reporting on sustainability aspects.

**CONTEMPORARY DEVELOPMENTS - INTEGRATED REPORTING**

Integrated reporting is a new approach to corporate reporting which is rapidly gaining international recognition. Integrated reporting is founded on integrated thinking, which helps demonstrate interconnectivity of strategy, strategic objectives, performance, risk and incentives and helps to identify sources of value creation.

Integrated Reporting is one step ahead of sustainability reporting and its set to become the way companies report their annual financial and sustainability information together in one report. The aim of an integrated report is to clearly and concisely tell the organization’s stakeholders about the company and its strategy and risks, linking its financial and sustainability performance in a way that gives stakeholders a holistic view of the organization and its future prospects.

The International Integrated Reporting Council (IIRC) defines integrated reporting as “a process that results in communication by an organization, most visibly a periodic integrated report, about how an organization’s strategy, governance, performance, and prospects lead to the creation of value over the short, medium and long-term.” It promotes a more cohesive and efficient approach to corporate reporting and aims to improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital.
Integrated Report

The primary purpose of an integrated report is to explain to providers of financial capital how an organization creates value over time. An integrated report benefits all stakeholders interested in an organization’s ability to create value over time, including employees, customers, suppliers, business partners, local communities, legislators, regulators and policy-makers. The International Framework (the Framework) takes a principles-based approach. The intent is to strike an appropriate balance between flexibility and prescription that recognizes the wide variation in individual circumstances of different organizations while enabling a sufficient degree of comparability across organizations to meet relevant information needs. It does not prescribe specific key performance indicators, measurement methods, or the disclosure of individual matters, but does include a small number of requirements that are to be applied before an integrated report can be said to be in accordance with the Framework. An integrated report may be prepared in response to existing compliance requirements, and may be either a standalone report or be included as a distinguishable, prominent and accessible part of another report or communication. It should include, transitionally on a comply or explain basis, a statement by those charged with governance accepting responsibility for the report.

Fundamental Concepts

An integrated report aims to provide insight about the resources and relationships used and affected by an organization – these are collectively referred to as “the capitals” in this Framework. It also seeks to explain how the organization interacts with the external environment and the capitals to create value over the short, medium and long term. The capitals are stocks of value that are increased, decreased or transformed through the activities and outputs of the organization. They are categorized in this Framework as financial, manufactured, intellectual, human, social and relationship, and natural capital, although organizations preparing an integrated report are not required to adopt this categorization or to structure their report along the lines of the capitals. The ability of an organization to create value for itself enables financial returns to the providers of financial capital. This is interrelated with the value the organization creates for stakeholders and society at large through a wide range of activities, interactions and relationships. When these are material to the organization’s ability to create value for itself, they are included in the integrated report.

International Integrated Reporting Framework (IIRC)

IIRC has developed an International Integrated Reporting Framework to establish Guiding Principles and Content Elements that govern the overall content of an integrated report, and to explain the fundamental concepts that underpin them. The Framework:

- Identifies information to be included in an integrated report for use in assessing the organization’s ability to create value; it does not set benchmarks for such things as the quality of an organization’s strategy or the level of its performance
- Is written primarily in the context of private sector, for-profit companies of any size but it can also be applied, adapted as necessary, by public sector and not-for-profit organizations.

The following Guiding Principles underpin the preparation of an integrated report, informing the content of the report and how information is presented:

- **Strategic focus and future orientation**: An integrated report should provide insight into the organization’s strategy, and how it relates to the organization’s ability to create value in the short, medium and long term, and to its use of and effects on the capitals
- **Connectivity of information**: An integrated report should show a holistic picture of the combination, interrelatedness and dependencies between the factors that affect the organization’s ability to create
value over time

- **Stakeholder relationships:** An integrated report should provide insight into the nature and quality of the organization’s relationships with its key stakeholders, including how and to what extent the organization understands, takes into account and responds to their legitimate needs and interests.

- **Materiality:** An integrated report should disclose information about matters that substantively affect the organization’s ability to create value over the short, medium and long term.

- **Conciseness:** An integrated report should be concise.

- **Reliability and completeness:** An integrated report should include all material matters, both positive and negative, in a balanced way and without material error.

- **Consistency and comparability:** The information in an integrated report should be presented: (a) on a basis that is consistent over time; and (b) in a way that enables comparison with other organizations to the extent it is material to the organization’s own ability to create value over time.

An integrated report should include eight Content Elements that are fundamentally linked to each other and are not mutually exclusive:

1. **Organizational overview and external environment:** What does the organization do and what are the circumstances under which it operates?
2. **Governance:** How does the organization’s governance structure support its ability to create value in the short, medium and long term?
3. **Business model:** What is the organization’s business model?
4. **Risks and opportunities:** What are the specific risks and opportunities that affect the organization’s ability to create value over the short, medium and long term, and how is the organization dealing with them?
5. **Strategy and resource allocation:** Where does the organization want to go and how does it intend to get there?
6. **Performance:** To what extent has the organization achieved its strategic objectives for the period and what are its outcomes in terms of effects on the capitals?
7. **Outlook:** What challenges and uncertainties is the organization likely to encounter in pursuing its strategy, and what are the potential implications for its business model and future performance?
8. **Basis of presentation:** How does the organization determine what matters to include in the integrated report and how are such matters quantified or evaluated?

**RELATION BETWEEN INTEGRATED REPORTING AND SUSTAINABILITY REPORTING**

Sustainability reporting is a process that assists organizations in setting goals, measuring performance and managing change towards a sustainable global economy – one that combines long term profitability with social responsibility and environmental care. Sustainability reporting – mainly through but not limited to a sustainability report – is the key platform for communicating the organization’s economic, environmental, social and governance performance, reflecting positive and negative impacts. The Aspects that the organization deems to be material, in response to its stakeholders’ expectations and interests, drive sustainability reporting. Stakeholders can include those who are invested in the organization as well as those who have other relationships with the organization.
Integrated reporting is an emerging and evolving trend in corporate reporting, which in general aims primarily to offer an organization's providers of financial capital with an integrated representation of the key factors that are material to its present and future value creation. Integrated reporters build on sustainability reporting foundations and disclosures in preparing their integrated report. Through the integrated report, an organization provides a concise communication about how its strategy, governance, performance and prospects lead to the creation of value over time. Therefore, the integrated report is not intended to be an extract of the traditional annual report nor a combination of the annual financial statements and the sustainability report. However, the integrated report interacts with other reports and communications by making reference to additional detailed information that is provided separately.

Although the objectives of sustainability reporting and integrated reporting may be different, sustainability reporting is an intrinsic element of integrated reporting. Sustainability reporting considers the relevance of sustainability to an organization and also addresses sustainability priorities and key topics, focusing on the impact of sustainability trends, risks and opportunities on the long term prospects and financial performance of the organization. Sustainability reporting is fundamental to an organization’s integrated thinking and reporting process in providing input into the organization’s identification of its material issues, its strategic objectives, and the assessment of its ability to achieve those objectives and create value over time.

### GLOSSARY OF TECHNICAL WORDS

- **Sustainable Development**: Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.
- **Corporate Sustainability**: Corporate sustainability is an approach that creates long-term stakeholder value by implementing a business strategy that considers every dimension of how a business operates in the ethical, social, environmental, cultural, and economic spheres.
- **Triple Bottom Line**: The triple bottom line is an accounting framework with three parts: social, environmental (or ecological) and financial. Some organizations have adopted the TBL framework to evaluate their performance in a broader perspective to create greater business value.
- **Sustainable Reporting**: A sustainability report is an organizational report that gives information about economic, environmental, social and governance performance.
- **Global Reporting Initiative**: The Global Reporting Initiative (known as GRI) is an international independent standards organization that helps businesses, governments and other organizations understand and communicate their impacts on issues such as climate change, human rights and corruption.

### LESSON ROUND-UP

- Corporate sustainability is imperative for the long-term sustainable development of the economy and society.
- The term sustainability accounting is used to describe the new information management and accounting methods that aim to create and provide high quality information to support a corporation in its movement towards sustainability.
- Sustainability reporting describes new formalized means of communication which provides information about corporate sustainability.
- The Sustainability Reporting Guidelines developed by the Global Reporting Initiative (GRI), the Netherlands, is a significant system that integrates sustainability issues in to a frame of reporting.
- Corporate Social Responsibility (CSR) is a concept whereby companies not only consider their profitability and growth, but also the interests of society and the environment by taking responsibility for the impact of their activities on stakeholders, environment, consumers, employees, communities, and all other members of the public sphere.
Sustainability (corporate sustainability) is derived from the concept of sustainable development which is defined by the Brundtland Commission as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs”.

Sustainability reporting is a process for publicly disclosing an organization’s economic, environmental, and social performance. Many companies find that financial reporting alone no longer satisfies the needs of shareholders, customers, communities and other stakeholders for information about overall organizational performance.

Business Responsibility Reporting (BRR) is a requirement mandated by the government of India, including CSR is by the SEBI which issued a circular on 13 August 2012 mandating the top 100 listed companies to report their ESG initiatives.

Corporate sustainability reports are usually developed either by employees from the environment or sustainability department or from corporate communications unit or by external agency.

Challenges in mainstreaming sustainability reporting are lack of (i) government encouragement; (ii) awareness about the sustainability reporting, (iii) Expertise Knowledge (iv) Investor behavior towards ESG parameters.

REFERENCE / LIST OF FURTHER READINGS


SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Discuss in detail about Global Reporting Initiative.
2. Explain Corporate Social Responsibility.
3. What is Sustainability Reporting?
4. Discuss about the Business Responsibility Reporting in India.
5. Write Short Notes on CSR Reporting Framework
Lesson 17
Measuring Business Sustainability

**LEARNING OBJECTIVES**

The objective of this study lesson is to enable the students to understand the models and approaches used for measuring the business sustainability.

**LESSON OUTLINE**

- Introduction
- Altman Z-Score
- Risk Adjusted Return on Capital
- Economic Value Added (EVA)
- Market Value Added (MVA)
- Sustainable Value Added Approach
- Glossary
- Lesson Round-Up
- Self Test Questions
INTRODUCTION

Sustainable Development is fast emerging in the forefront of the business agenda the world over. In recent years different business reporting models have evolved that guide companies to understand, demonstrate, communicate, report and improve their sustainability performance. The chapter explains the various models and approaches used for measuring the business sustainability. This chapter also explains how these models work and the accuracy and effectiveness of these models or approaches. Information Technology can play an important role in sustainability management, and can be gainfully leveraged specifically in the evaluation of sustainability performance.

ALTMAN Z-SCORE

Published in 1968 by Edward I. Altman, an Assistant Professor of Finance at New York University, ‘Z-score formula’ is for predicting bankruptcy. The formula helps to predict the probability of a firm to go into bankruptcy within next two years. In 1960s, an idea of trying to predict which companies would be unsuccessful in the near future was far from new at that time. Altman added a statistical technique called multivariate analysis to the mix of traditional ratio-analysis techniques. Adding multivariate analysis allowed him to consider the effects of several ratios on the ‘predictiveness’ of his bankruptcy model. In addition to this it allowed to consider how those ratios affected each other’s usefulness in the model.

Z-scores are used to predict corporate defaults and an easy-to-calculate control measure for the financial distress status of companies. The Z-score uses multiple corporate income and balance sheet values to measure the financial health of a company. Altman developed the Z-Score after evaluating 66 companies, 33 of which had filed for bankruptcy. He started with 22 ratios classified into five different categories such as liquidity, profitability, leverage, solvency and activity. Eventually he narrowed it down to five ratios.

How this method works?

The Z-score is a linear combination of five common business ratios, weighted by coefficients. The coefficients were estimated by identifying a set of firms which had declared bankruptcy and then collecting a matched sample of firms which had survived, with matching by industry and approximate size (assets).

Altman applied the statistical method of discriminant analysis to a dataset of publicly held manufacturers. The estimation was originally based on data from publicly held manufacturers, but has since been re-estimated based on other datasets for private manufacturing, non-manufacturing and service companies.

The Altman Z Score formula is based on information found in the income statement and balance sheet of an organization; as such, it can be readily derived from commonly-available information.

Formula

\[ Z\text{-Score} = 1.2A + 1.4B + 3.3C + 0.6D + 1.0E \]

Where:

- A = working capital / total assets: -This ratio measures liquid assets. The companies in trouble will usually experience shrinking liquidity.
- B = retained earnings / total assets: -This ratio calculates the overall profitability of the company. Dwindling profitability is a warning sign.
- C = earnings before interest and tax / total assets: -This ratio shows how productive a company is in generating earnings, relative to its size.
Lesson 17  Measuring Business Sustainability

- \( D = \frac{\text{market value of equity}}{\text{total liabilities}} \): This ratio suggests how far the company’s assets can decline before it becomes technically insolvent (i.e., its liabilities become higher than its assets).

- \( E = \frac{\text{sales}}{\text{total assets}} \): This is the asset turnover ratio and is a measure of how effectively the firm uses its assets to generate sales.

A Z score of greater than 2.99 means that the entity being measured is safe from bankruptcy. A score of less than 1.81 means that a business is at considerable risk of going into bankruptcy, while scores in between should be considered a red flag for possible problems. The model has proven to be reasonably accurate in predicting the future bankruptcy of entities under analysis.

This scoring system was originally designed for manufacturing firms having assets of $1 million or more. Given the targeted nature of the model, it has since been modified to be applicable to other types of organizations.

This approach to evaluating organizations is better than using just a single ratio, since it brings together the effects of multiple items - assets, profits, and market value. As such, it is most commonly used by creditors and lenders to determine the risk associated with extending funds to customers and borrowers.

Over time, however, the Z-Score has proved to be one of the most reliable predictors of bankruptcy -- so much so that analysts often equate certain Z-Scores with corresponding bond ratings. In fact, when Altman reevaluated his methods by examining 86 distressed companies from 1969 to 1975 and then 110 bankrupt companies from 1976 to 1995 and later 120 bankrupt companies from 1996 to 1999, the Z-Score was between 82% and 94% accurate. The old "garbage in, garbage out" motto applies, however: if the company financials are misleading or incorrect, the Z-Score will be too.

It's important to remember that changes in a company's Z-Score are as important, if not more important, than the Z-Score itself. After all, knowing a company is heading down the wrong path is better than learning about it after the fact. For example, Enron's Z-Score gave it the equivalent of a BBB bond rating at year-end 1999, but it had a score equal to a B rating by June 2001 -- unlike the ratings agencies, which rated Enron as BBB until just before it filed for bankruptcy.

**Accuracy and effectiveness**

In its initial test, the Altman Z-Score was found to be 72% accurate in predicting bankruptcy two years before the event, with a Type II error (false negatives) of 6% (Altman, 1968). In a series of subsequent tests covering three periods over the next 31 years (up until 1999), the model was found to be approximately 80%–90% accurate in predicting bankruptcy one year before the event, with a Type II error (classifying the firm as bankrupt when it does not go bankrupt) of approximately 15%–20% (Altman, 2000).

From about 1985 onwards, the Z-scores gained wide acceptance by auditors, management accountants, courts, and database systems used for loan evaluation (Eidleman). The formula's approach has been used in a variety of contexts and countries, although it was designed originally for publicly held manufacturing companies with assets of more than $1 million. Later variations by Altman were designed to be applicable to privately held companies (the Altman Z'-Score) and non-manufacturing companies (the Altman Z''-Score).

Neither the Altman models nor other balance sheet-based models are recommended for use with financial companies. This is because of the opacity of financial companies' balance sheets and their frequent use of off-balance sheet items. There are market-based formulas used to predict the default of financial firms, but these have limited predictive value because they rely on market data (fluctuations of share and options prices to imply fluctuations in asset values) to predict a market event (default, i.e., the decline in asset values below the value of a firm's liabilities).
Altman Z-Scores and the Financial Crisis

In 2007, the credit ratings of specific asset-related securities had been rated higher than they should have been. The Altman Z-score indicated that the companies' risks were increasing significantly and may have been heading for bankruptcy.

Altman calculated that the median Altman Z-score of companies in 2007 was 1.81. These companies' credit ratings were equivalent to B. This indicated that 50% of the firms should have been rated lower, and they were highly distressed and had a high probability of becoming bankrupt.

Altman's calculations led him to believe that a crisis would occur and there would be a meltdown in the credit market. Altman believed the crisis would stem from corporate defaults, but the meltdown began with mortgage-backed securities (MBS). However, corporations soon defaulted in 2009 at the second-highest rate in history.

'RISK-ADJUSTED RETURN ON CAPITAL - RAROC'

Risk-adjusted return on capital (RAROC) is a profitability metric that can be used to analyse return in relation to the level of risk taken on. It can be used to compare the performance of several investments with differing levels of risk exposure. It should not be confused with RORAC (return on risk-adjusted capital) which adjusts the capital invested based on the risks being taken. RAROC instead adjusts the return itself. RAROC was developed by Bankers Trust in the late 1970s and early 1980s in response to regulatory interest in the capital ratios of financial institutions and the implementation of capital adequacy regulations. RAROC is often used by banks to determine the amount of capital required to support the bank's activities.

Basic formulas

\[ \text{RAROC} = \text{expected return} / \text{Economic Capital} \]

Or

\[ \text{RAROC} = \frac{\text{Expected Return}}{\text{Value at risk}} \]

In business enterprises, risk is traded off against benefit. RAROC is defined as the ratio of risk adjusted return to economic capital. The economic capital is the amount of money which is needed to secure the survival in a worst-case scenario, it is a buffer against unexpected shocks in market values. Economic capital is a function of market risk, credit risk, and operational risk, and is often calculated by VaR. (Value at risk (VaR) is a measure of the risk of loss for investments.) This use of capital based on risk improves the capital allocation across different functional areas of banks, insurance companies, or any business in which capital is placed at risk for an expected return above the risk-free rate.

RAROC system allocates capital for two basic reasons:

1. Risk management
2. Performance evaluation

For risk management purposes, the main goal of allocating capital to individual business units is to determine the bank's optimal capital structure—that is economic capital allocation is closely correlated with individual business risk. As a performance evaluation tool, it allows banks to assign capital to business units based on the economic value added of each unit.

Risk-adjusted return on capital (RAROC) is a modified return on investment (ROI) figure that takes elements
of risk into account. The formula used to calculate RAROC is:

\[
\text{RAROC} = \frac{\text{revenue} - \text{expenses} - \text{expected loss} + \text{income from capital}}{\text{capital}}
\]

Where:
Income from capital = (capital charges) × (risk-free rate)

This is calculated by multiplying capital charges by the risk-free rate. This is because, since capital is set aside to support a risky transaction, it should theoretically be invested in something ‘risk free’.

Expected loss is the average anticipated loss over the period being measured. It will include the cost of doing business as well as any loss incurred from default or operational risk.

Capital means economic capital is the amount of capital that a financial institution needs to ensure that the company remains solvent. It should be sufficient to support any risks that the company takes on.

In financial analysis, projects and investments with greater risk levels must be evaluated differently; RAROC accounts for changes in an investment’s profile by discounting risky cash flows against less-risky cash flows.

**Risk Management**

Commercial lending institutes such as banks acting as financial intermediaries that accept deposits from public and lend it out to borrowers. The borrowers, in turn, repay the amount borrowed along with an additional sum known as the interest. This interest is fixed by the bank in a way that it covers the cost of operations, the cost of sourcing funds, and the yield for the shareholders of the bank’s equity. But the whole operation of borrowing and lending may not be running as smoothly as expected.

A bank may face external or internal fluctuations or disruptions in its daily operations which are known as risks. These risks could be related to macro (industry related) or micro (firm specific) factors in which the firm operates. A financial institution is exposed to operational, credit and market risks in its daily course of business.

**Operational risk** is the risk which is not inherent in the business. It relates to human error, fraud, or breakdown of systems and processes.

**Credit risks** primarily arise from the risk of default of borrowers when the borrower fails to make required payments back to the financial institution.

**Market risk** is appears in forms of fluctuation in prices in the financial markets and the possibility for an investor to experience losses.

**BREAKING DOWN 'Risk-Adjusted Return on Capital - RAROC’**

Risk-adjusted return on capital is a useful tool in assessing potential acquisitions. The general underlying assumption of RAROC is investments or projects with higher levels of risk offer substantially higher returns. Companies that need to compare two or more different projects or investments must keep this in mind.

**RAROC and Bankers Trust**

RAROC is also referred to as a profitability-measurement framework, based on risk that allows analysts to examine a company’s financial performance and establish a steady view of profitability across business sectors and industries.
The RAROC metric was developed during the late 1970s by Bankers Trust, more specifically Dan Borge, its principal designer. The tool grew in popularity through the 1980s, serving as a newly developed adjustment to simple return on capital (ROC). A commercial bank at the time, Bankers Trust adopted a business model similar to that of an investment bank. Bankers Trust had unloaded its retail lending and deposit businesses and dealt actively in exempt securities, with a derivative business beginning to take root.

These wholesale activities facilitated the development of the RAROC model. Nationwide publicity led a number of other banks to develop their own RAROC systems. The banks gave their systems different names, essentially lingo used to indicate the same type of metric. Other names include return on risk-adjusted capital (RORAC) and risk-adjusted return on risk-adjusted capital (RARORAC). The most commonly used present term for the metric is still RAROC. Nonbanking firms utilize RAROC as a metric for the effect that operational, market and credit risk has on finances.

### ECONOMIC VALUE ADDED (EVA)

EVA is promoted by a consulting firm Stern Steward & Co., which was established in 1982 and pioneered the EVA concept in 1989. EVA is a performance measure that captures the true economic profit of an enterprise. EVA is used by over 300 successful companies.

#### Concept of Economic Value Added (EVA)

EVA is a value based financial performance measure. It is an investment decision tool and it is also a performance measure reflecting the absolute amount of shareholder value created. It is computed as the product of the “excess return” made on an investment or investments and the capital invested in that investment or investments.

“Economic Value Added (EVA) is the net operating profit minus an appropriate charge for the opportunity cost of all capital invested in an enterprise or project. It is an estimate of true economic profit, or amount by which earnings exceed or fall short of the required minimum rate of return investors could get by investing in other securities of comparable risk (Stewart, 1990).”

EVA is a variation of residual income with adjustments to how one calculates income and capital. Stern Stewart & Co., a consulting firm based in New York, introduced the concept on EVA as a measurement tool in 1989, and trademarked it.

\[
EVA = \text{after-tax operating profits} - \text{total costs of capital.}
\]

After-tax operating profits = net income + after-tax interest expenses.

Total costs of capital are the required profits to give a competitive return on the capital employed, i.e, total capital (in $) * WACC.

If EVA > 0, benefit to shareholders

The EVA concept is often called Economic Profit (EP) to avoid problems caused by the trade marking. EVA is so popular and well known that all residual income concepts are often called EVA even though they do not include the main elements defined by Stern Stewart & Co. (Pinto, 2001).

Up to 1970 residual income did not get wide publicity and it did not end up to be the prime performance measure in Companies. However, EVA has done it in recent years.

In the 1990’s, the creation of shareholder value has become the ultimate economic purpose of a corporation. Firms focus on building, operating and harvesting new businesses and/or products that will provide a greater
return than the firm’s cost of capital, thus ensuring maximization of shareholder value. EVA is a strategy formulation and financial performance management tool that help Companies make a return greater than the firm’s cost of capital. Firms adopt this concept to track their financial position and to guide management decisions regarding resource allocation, capital budgeting and acquisition analysis (Geyser & Liebenberg, 2003).

EVA emphasizes the residual wealth creation in a Company after all costs and expenses have been charged including the firm’s cost of capital invested.

In its simplest terms, EVA measures how much economic value in dollars; the Company is creating, taking into account the cost of debt and equity capital (Adnan & Timothy, 2002). The term EVAis a registered trademark of the consulting firm of Stern.

Stewart, represents the specific version of residual income used by the firm. It is defined as:

\[ \text{EVA} = \text{NOPAT} - (\text{Invested Capital} \times \text{WACC}) \]

The cost of capital is a weighted average that reflects the cost of both debt and equity capital. Thus, EVA measures the excess of a firm’s operating income over the cost of the capital employed in generating those earnings. It relates operating income to capital employed in an additive operation. This is in contrast to return on assets (\( \text{ROA} = \frac{\text{operating income}}{\text{capital}} \)), which compares operating income to capital employed in a multiplicative operation.

The primary argument advanced in favour of residual income and EVA is that they may encourage managers to undertake desirable investments and activities that will increase the value of the firm, whereas ROA may not (MacIntyre, 1999).

Features of the EVA:

- It consider the charge for capital or the opportunity cost of capital.
- The Profit after tax (PAT) considers only the cost of debt and do not consider the cost of equity. The EVA concept takes into the account of cost of equity too.
- EVA is the simplest and effective method of teaching business literacy to even the least sophisticated workers.
- Improvement in EVA indicates improvement in shareholder’s wealth, which may not be true in case of other measures like EPS, Profit.
- EVA can act as an internal system of corporate governance by bringing all departments together.
- Eva can act as a means of communication with investors-existing as well as potential to help them in choosing investment options.

**Market Value Added (MVA)**

Market Value Added (MVA) is a tool to measure shareholder’s value at a particular moment this was introduced by Stewart in 1991. Market Value Added (MVA) is the additional market capitalization over and above the book value of equity (Gupta & Kundu, 2008).

From an investor’s point of view, MVA is the best final measure of a Company’s performance. Stewart (1991) states that MVA is a cumulative measure of corporate performance and that it represents the stock market’s assessment from a particular time onwards of the net present value of all a Company’s past and projected value.
capital projects. MVA is calculated at a given moment, but in order to assess performance over time, the difference or change in MVA from one date to the next can be determined to see whether value has been created or destroyed.

MVA can be summarized that there are basically only three ways in which a Company can increase its MVA (Stewart, 1991; Ernst & Young, 1994; Firer, 1995; Davidson, 2003):

- By making new investments in projects with a positive return spread (positive EVA);
- expanding current projects earning a positive EVA; and
- By scaling down or eliminating projects that have a negative EVA.

The Market Value Added (MVA) measure is based on the assumption that the total market value of a firm is the sum of the market value of its equity and the market value of its debt. Stewart (1991) defines Market Value Added (MVA) as the excess of market value of capital (both debt and equity) over the book value of capital.

It is typically used for companies that are larger and publicly-traded. MVA is not a performance metric like EVA, but instead is a wealth metric, measuring the level of value a company has accumulated over time.

In another words Market Value Added (MVA) is the difference between the current market value of a firm (V) and the capital contributed by its investors (K):

\[ \text{Market Value Added (MVA)} = V - K \]

If the Market Value Added (MVA) is positive, the Company has created wealth for its shareholders. If it is negative, then the firm has destroyed value. The capital is the amount that is put in the Company by the shareholders.

According to Stern and Shiely (2001), in order to calculate the market value of a firm, we have to value the equity part at its market price on the date the calculation is made. The total investment in the Company since day one is then calculated as the interest-bearing debt and equity, which includes retained earnings. Present market value is then compared with total investment. If the former amount is greater than the latter, the Company has created wealth.

Stewart (1991) states that Market Value Added (MVA) is an cumulative measure of corporate performance and that it represents the stock markets assessments from a particular time onwards of the net present value of all of a Company’s past and projected capital projects. The disadvantage of the method is that like EVA there can be a number of value based adjustments made in order to arrive at the economic book value and that it is affected by the volatility from the market values, since it tends to move in tandem with the market.

**Calculation of Market Value Added (MVA)**

Market Value Added (MVA) is the difference between the total market value of the Company and the economic capital (Firer, 1995; Reilly & Brown, 2003). A Company’s total market value is equal to the sum of the market value of its equity and the market value of its debt. In theory, this amount is what can be “taken out” of the Company (i.e. when all shares are sold and debt is repaid) at any given time.

\[ \text{MVA} = \text{Market value of Company} - \text{Invested Capital} \]

\[ \text{MVA} = \text{MV} - \text{IC} \]
Where;

- **MV**: Market Value of Company
- **WACC**: Weighted Average Cost of Capital
- **IC**: Invested Capital
- **MVA**: Market Value Added

From an investor's point of view, MVA is the best final measure of a Company's performance. Stewart (1991) states that MVA is a cumulative measure of corporate performance and that it represents the stock market's assessment from a particular time onwards of the net present value of all a Company's past and projected capital projects. MVA is calculated at a given moment, but in order to assess performance over time, the difference or change in MVA from one date to the next can be determined to see whether value has been created or destroyed.

Company creates value when **MVA > 0** that is when the market value of capital exceeds the capital invested. A negative value for MVA proves that the provisions concerning the ability of management to use efficiently the capital are unfavourable. The link between EVA and MVA is that MVA is the present value of all the future EVA's a Company is expected to generate, discounted at the WACC.

\[
\text{Market Value Added (MVA)} = \text{PV (future EVA)}
\]

Theoretically, MVA is equal to the present value of all future EVA's. On the assumption that there will be no future growth in the current EVA, or that the expected future growth in EVA will be at a constant rate, \( g \), the theoretical MVA can be calculated as perpetuity. The result shows that MVA is a multiple of the current EVA.

If no future growth in EVA is expected, the theoretical MVA can be calculated as follows:

\[
\text{MVA} = \frac{\text{PV (future EVA)}}{\text{WACC}} \quad (2)
\]

Where,
- **PV**: Present Value
- **EVA**: Economic Value Added
- **WACC**: Weighted Average Cost of Capital

### Difference between EVA and MVA

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<tr>
<th>EVA</th>
<th>MVA</th>
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<tr>
<td>EVA is an estimate of a firm's economic profit. i.e., the profit earned by the firm less the cost of financing the firm's capital</td>
<td>MVA is the difference between the current market value of the firm and the capital contributed by investors.</td>
</tr>
<tr>
<td>The computation of this determines the performance of a company over a period.</td>
<td>The computation of this provides a summary of how well the company has made the most of the shareholder values since its beginning.</td>
</tr>
<tr>
<td>A higher number is better because it proves that there has been a growth in the flow of profit for the time in question.</td>
<td>A higher number is better because it means that shareholder value has surged over the life of the company.</td>
</tr>
</tbody>
</table>
Compared to MVA, you can compute the EVA units within the company instead of the whole company. For instance, you can compute the EVA of departments and product lines. This offers more informative analysis and comparisons.

It is a collective figure because it gives information on the company as a whole. This is due to figures such as market value and total investment is applicable to the entire company.

**SUSTAINABLE VALUE ADDED**

Traditionally, an enterprise focuses on value maximization. The conventional management takes into account just one dimension – economic – when creating value in an enterprise. All resources including environmental and social resources are neglected. This point of view is not acceptable when speaking about sustainable development. Over the last decades, theorists emphasize wider scope of entrepreneurial objectives besides obtaining the greatest value possible. Sustainable development is a normative concept laid out as the combination of economic prosperity, environmental integrity and social equity. Value is created whenever benefits exceed costs.

Sustainable Value Added takes into account both, the efficiency and the absolute level (effectiveness) of resource use. It has never been more important for businesses to use their economic, environmental and social resources efficiently. Conceptually, SVA stresses the complementary disposition of economic, environmental and social resources. Sustainable Value Added is the extra value created when the overall level of environmental and social impacts is kept constant.

Current approaches to measure corporate sustainable performance take into account external costs caused by environmental and social damage or focus on the ratio between value creation and resource consumption.

As Sustainable Value Added is inspired by strong sustainability, it measures whether a company creates extra value while ensuring that every environmental and social impact is in total constant. Therefore, it takes into account both, corporate eco and social efficiency as well as the absolute level of environmental and social resource consumption (eco and social effectiveness). As a result, Sustainable Value Added considers simultaneously economic, environmental and social aspects. The overall result can be expressed in any of the three dimensions of sustainability.

Sustainable Value Added allows assessing the sustainable performance of enterprises similar to financial performance in monetary terms and this, in turn, enhances creative leadership and better formulation of a resource efficient business strategy.

**GLOSSARY OF TECHNICAL WORDS**

- **EVA**: EVA is a value based financial performance measure. It is an investment decision tool and it is also a performance measure reflecting the absolute amount of shareholder value created. It is computed as the product of the “excess return” made on an investment or investments and the capital invested in that investment or investments.

- **MVA**: Market Value Added (MVA) is the difference between the total market value of the Company and the economic capital. A Company's total market value is equal to the sum of the market value of its equity and the market value of its debt. In theory, this amount is what can be “taken out” of the Company (i.e. when all shares are sold and debt is repaid) at any given time.

- **Operational Risk**: Operational risk is the risk not inherent in financial, systematic or market-wide risk. It is the risk remaining after determining financing and systematic risk, and includes risks resulting from breakdowns in internal procedures, people and systems.
• **Credit Risk:** Credit risk is most simply defined as the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms. The goal of credit risk management is to maximise a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters.

• **Market Risk:** Market risk is the possibility of an investor experiencing losses due to factors that affect the overall performance of the financial markets in which he or she is involved. Market risk, also called “systematic risk,” cannot be eliminated through diversification, though it can be hedged against.

### LESSON ROUND UP

- The Altman Z Score is used to predict the likelihood that a business will go bankrupt within the next two years. The formula is based on information found in the income statement and balance sheet of an organization; as such, it can be readily derived from commonly-available information.

- The formula for the calculation of the Z Score is: $1.2A + 1.4B + 3.3C + 0.6D + 1.0E$

- Risk-adjusted return on capital (RAROC) is a profitability metric that can be used to analyse return in relation to the level of risk taken on. It can be used to compare the performance of several investments with differing levels of risk exposure. It should not be confused with RORAC (return on risk-adjusted capital) which adjusts the capital invested based on the risks being taken. RAROC instead adjusts the return itself. RAROC was developed by Bankers Trust in the late 1970s and early 1980s in response to regulatory interest in the capital ratios of financial institutions and the implementation of capital adequacy regulations. RAROC is often used by banks to determine the amount of capital required to support the bank’s activities. Basic formula for RAROC = Expected Return / Economic Capital.

- Operational risk is the risk which is not inherent in the business. It relates to human error, fraud, or breakdown of systems and processes.

- Credit risks primarily arise from the risk of default of borrowers when the borrower fails to make required payments back to the financial institution.

- Market risk is appears in forms of fluctuation in prices in the financial markets and the possibility for an investor to experience losses.

- EVA is a value based financial performance measure. It is an investment decision tool and it is also a performance measure reflecting the absolute amount of shareholder value created. It is computed as the product of the “excess return” made on an investment or investments and the capital invested in that investment or investments.

- Market Value Added (MVA) is the difference between the total market value of the Company and the economic capital. A Company’s total market value is equal to the sum of the market value of its equity and the market value of its debt. In theory, this amount is what can be “taken out” of the Company (i.e. when all shares are sold and debt is repaid) at any given time.

### REFERENCE FOR FURTHER READING

https://www.investopedia.com/terms/a/altman.asp

https://en.wikipedia.org/wiki/Altman_Z-score

https://www.investopedia.com/terms/a/altman.asp


SELF-TEST QUESTIONS

1. What is the importance of Altman Z score?
2. What is RAROC?
3. What is EVA?
4. What is MVA?
5. Point out the difference between EVA and MVA.
“Corruption is the enemy of development, and of good governance. It must be got rid of. Both the government and the people at large must come together to achieve this national objective.”

- Pratibha Patel
INTRODUCTION

The Indian economy is characterized by the presence of a big government – the Indian political structure encompasses central and state governments, as well as various local self-governance structures. Apart from performing functions such as regulation and licensing, the government also operates large commercial enterprises in several sectors, including education, defence, aviation, railways (a near monopoly), infrastructure and healthcare – accordingly, interactions with the government (in its various forms) and government owned enterprises are unavoidable for entities looking to do business in India. It is also important to bear in mind that Indian laws and regulations often provide for considerable discretion in the hands of government agencies and personnel, and this can make interacting with government a subjective and time-consuming exercise.

While Indian anti-corruption laws are fairly stringent, corruption is not uncommon in India, and until recently the enforcement of anti-corruption laws left much to be desired. This has led to unfortunate notion (particularly outside India) that corruption is an accepted practice in India – however, this notion is misplaced, and recent years have been marked with growing public dissatisfaction over corruption and its cost to the Indian economy. Over the past five to six years, there has been a strong public sentiment against corruption, and high-profile instances of corruption have become key political and election issues – for example, the incumbent Indian government has also taken a hard line stance on corruption issues.

These factors has prompted the introduction of several legislative measures aimed at tackling corruption in India, including the creation of an independent ombudsman (the Lokpal) to investigate and prosecute cases of corruption to the public officials (including ministers), expansion of existing laws governing money laundering and ‘bemani’ (i.e. proxy) transactions, and new laws to target undisclosed income and assets (whether in India or abroad). Most importantly, the past few years have seen a change in attitude of enforcement agencies, which have started enforcing anti-corruption laws aggressively in India, and have been supported in their efforts by the judiciary (which has taken up an active role in monitoring corruption cases).

Brief Information on the laws and enforcement regime

(A) PREVENTION OF CORRUPTION ACT, 1988 (THE PCA)

The PCA criminalises the acceptance of gratification (pecuniary or otherwise) other than the acceptance of legal remuneration by public servants which is paid by their employers in connection with the performance of their duties. Aiding and abetting the commission of bribery is also an offence, such that any person, who bribes or attempts to bribe a public servant or acts as a middleman for such bribing may also be held liable. Further, the PCA creates an adverse presumption if a public servant’s assets are disproportionate in value to his or her income and cannot be satisfactorily accounted for. The provisions of the PCA apply regardless of the location or jurisdiction of the commission of an offence, as long as the same is committed by a ‘public servant’ as defined under it. Judicial decisions have also interpreted the term ‘public servant’ in the PCA to include a wide variety of persons, such as bank employees in both private and government owned banks.

The Prevention of Corruption Act, 1988 (No. 49 of 1988) is an Act of the Parliament of India enacted to combat corruption in government agencies and public sector businesses in India. This law defines who a public servant is and punishes public servants involved in corruption or bribery. It also punishes anyone who helps him or her commit the crime corruption or bribery. It extends to the whole of India except the State of Jammu and Kashmir and it applies also to all citizens of India outside India.

Features of bribery offences

The PCA is primarily directed at public servants, which is broadly defined to include any person who is:
○ in the service or pay of the Government, local authority, Government corporation;
○ related to the administration of justice,
○ empowered to conduct elections,
○ appointed to perform public duty,
○ an office bearer of Government aided cooperative society,
○ an employee of any service commission, or
○ a member of any university.

As indicated earlier, the PCA only deals with bribery of public servants. It does not extend to bribery or corruption in the private sector, i.e. where a public servant is not involved. That said, a private person/entity will be liable for inducing a public servant to commit an act that is prohibited by the PCA, by corrupt or illegal means or by exercising personal influence.

**Public servant taking gratification other than legal remuneration in respect of an official act**

[Section 7]

Whoever, being, or expecting to be a public servant, accepts or obtains or agrees to accept or attempts to obtain from any person, for himself or for any other person, any gratification whatever, other than legal remuneration, as a motive or reward for doing or forbearing to do any official act or for showing or forbearing to show, in the exercise of his official functions, favour or disfavour to any person or for rendering or attempting to render any service or disservice to any person, with the Central Government or any State Government or Parliament or the Legislature of any State or with any local authority, corporation or Government company referred to in clause (c) of section 2, or with any public servant, whether named or otherwise, shall be punishable with imprisonment which shall be not less than three years but which may extend to seven years and shall also be liable to fine.

Explanations.—(a) “Expecting to be a public servant.” If a person not expecting to be in office obtains a gratification by deceiving others into a belief that he is about to be in office, and that he will then serve them, be may be guilty of cheating, but he is not guilty of the offence defined in this section.

(b) “Gratification.” The word “gratification” is not restricted to pecuniary gratifications or to gratifications estimable in money.

(c) “Legal remuneration.” The words “legal remuneration” are not restricted to remuneration which a public servant can lawfully demand, but include all remuneration which he is permitted by the Government or the organisation, which he serves, to accept.

(d) “A motive or reward for doing.” A person who receives a gratification as a motive or reward for doing what he does not intend or is not in a position to do, or has not done, comes within this expression.

(e) Where a public servant induces a person erroneously to believe that his influence with the Government has obtained a title for that person and thus induces that person to give the public servant, money or any other gratification as a reward for this service, the public servant has committed an offence under this section.

**Taking gratification, in order, by corrupt or illegal means, to influence public servant**

[Section 8]

Whoever accepts or obtains, or agrees to accept, or attempts to obtain, from any person, for himself or for
any other person, any gratification whatever as a motive or reward for inducing, by corrupt or illegal means, any public servant, whether named or otherwise, to do or to forbear to do any official act, or in the exercise of the official functions of such public servant to show favour or disfavour to any person, or to render or attempt to render any service or disservice to any person with the Central Government or any State Government or Parliament or the Legislature of any State or with any local authority, corporation or Government company referred to in clause (c) of section 2, or with any public servant, whether named or otherwise, shall be punishable with imprisonment for a term which shall be not less than three years but which may extend to seven years and shall also be liable to fine.

**Taking gratification, for exercise of personal influence with public servant [Section 9]**

Whoever accepts or obtains or agrees to accept or attempts to obtain, from any person, for himself or for any other person, any gratification whatever, as a motive or reward for inducing, by the exercise of personal influence, any public servant whether named or otherwise to do or to forbear to do any official act, or in the exercise of the official functions of such public servant to show favour or disfavour to any person, or to render or attempt to render any service or disservice to any person with the Central Government or any State Government or Parliament or the Legislature of any State or with any local authority, corporation or Government company referred to in clause (c) of section 2, or with any public servant, whether named or otherwise, shall be punishable with imprisonment for a term which shall be not less than three years but which may extend to seven years and shall also be liable to fine.

**Punishment for abetment by public servant of offences defined in section 8 or 9 [Section 10]**

Whoever, being a public servant, in respect of whom either of the offences defined in section 8 or section 9 is committed, abets the offence, whether or not that offence is committed in consequence of that abetment, shall be punishable with imprisonment for a term which shall be not less than six months but which may extend to five years and shall also be liable to fine.

**Public servant obtaining valuable thing, without consideration from person concerned in proceeding or business transacted by such public servant [Section 11]**

Whoever, being a public servant, accepts or obtains or agrees to accept or attempts to obtain for himself, or for any other person, any valuable thing without consideration, or for a consideration which he knows to be inadequate, from any person whom he knows to have been, or to be, or to be likely to be concerned in any proceeding or business transacted or about to be transacted by such public servant, or having any connection with the official functions of himself or of any public servant to whom he is subordinate, or from any person whom he knows to be interested in or related to the person so concerned, shall be punishable with imprisonment for a term which shall be not less than six months but which may extend to five years and shall also be liable to fine.

**Punishment for abetment of offences defined in section 7 or 11 [Section 12]**

Whoever abets any offence punishable under section 7 or section 11 whether or not that offence is committed in consequence of that abetment, shall be punishable with imprisonment for a term which shall be not less than three years but which may extend to seven years and shall also be liable to five. 13. Criminal misconduct by a public servant.—(1) A public servant is said to commit the offence of criminal misconduct,—(a) if he habitually accepts or obtains or agrees to accept or attempts to obtain from any person for himself or for any other person any gratification other than legal remuneration as a motive or reward such as is mentioned in section 7; or (b) if he habitually accepts or obtains or agrees to accept or attempts to obtain for himself or for any other person, any valuable thing without consideration or for a consideration which he
knows to be inadequate from any person whom he knows to have been, or to be, or to be likely to be concerned in any proceeding or business transacted or about to be transacted by him, or having any connection with the official functions of himself or of any public servant to whom he is subordinate, or from any person whom he knows to be interested in or related to the person so concerned; or (c) if he dishonestly or fraudulently misappropriates or otherwise converts for his own use any property entrusted to him or under his control as a public servant or allows any other person so to do; or (d) if he,— (i) by corrupt or illegal means, obtains for himself or for any other person any valuable thing or pecuniary advantage; or (ii) by abusing his position as a public servant, obtains for himself or for any other person any valuable thing or pecuniary advantage; or (iii) while holding office as a public servant, obtains for any person any valuable thing or pecuniary advantage without any public interest; or (e) if he or any person on his behalf, is in possession of property or has, at any time during the period of his office, been in possession for which the public servant cannot satisfactorily account, of pecuniary resources or property disproportionate to his known sources of income. Explanation.—For the purposes of this section, “known sources of income” means income received from any lawful source and such receipt has been intimated in accordance with the provisions of any law, rules or orders for the time being applicable to a public servant. (2) Any public servant who commits criminal misconduct shall be punishable with imprisonment for a term which shall be not less than four years but which may extend to ten years and shall also be liable to fine.

**Habitual committing of offence under sections 8, 9 and 12: [Section 14]**

Whoever habitually commits— (a) an offence punishable under section 8 or section 9; or (b) an offence punishable under section 12, shall be punishable with imprisonment for a term which shall be not less than five years but which may extend to ten years and shall also be liable to fine.

**Punishment for attempt [Section 15]**

Whoever attempts to commit an offence referred to in clause (c) or clause (d) of sub-section (1) of section 13 shall be punishable with imprisonment for a term which shall not be less than two years but which may extend to five years and with fine.

**Matters to be taken into consideration for fixing fine [Section 16]**

Where a sentence of fine is imposed under sub-section (2) of section 13 or section 14, the court in fixing the amount of the fine shall take into consideration the amount or the value of the property, if any, which the accused person has obtained by committing the offence or where the conviction is for an offence referred to in clause (e) of sub-section (1) of section 13, the pecuniary resources or property referred to in that clause for which the accused person is unable to account satisfactorily

**Persons authorised to investigate [Section 17]**

Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), no police officer below the rank,— (a) in the case of the Delhi Special Police Establishment, of an Inspector of Police; (b) in the metropolitan areas of Bombay, Calcutta, Madras and Ahmedabad and in any other metropolitan area notified as such under sub-section (1) of section 8 of the Code of Criminal Procedure, 1973 (2 of 1974), of an Assistant Commissioner of Police; (c) elsewhere, of a Deputy Superintendent of Police or a police officer of equivalent rank, shall investigate any offence punishable under this Act without the order of a Metropolitan Magistrate or a Magistrate of the first class, as the case may be, or make any arrest therefor without a warrant: Provided that if a police officer not below the rank of an Inspector of Police is authorised by the State Government in this behalf by general or special order, he may also investigate any such offence without the order of a Metropolitan Magistrate or a Magistrate of the first class, as the case may be, or make
arrest therefor without a warrant: Provided further that an offence referred to in clause (e) of sub-section (1) of section 13 shall not be investigated without the order of a police officer not below the rank of a Superintendent of Police.

**Power to inspect bankers’ books [Section 18]**

If from information received or otherwise, a police officer has reason to suspect the commission of an offence which he is empowered to investigate under section 17 and considers that for the purpose of investigation or inquiry into such offence, it is necessary to inspect any bankers’ books, then, notwithstanding anything contained in any law for the time being in force, he may inspect any bankers’ books in so far as they relate to the accounts of the persons suspected to have committed that offence or of any other person suspected to be holding money on behalf of such person, and take or cause to be taken certified copies of the relevant entries therefrom, and the bank concerned shall be bound to assist the police officer in the exercise of his powers under this section: Provided that no power under this section in relation to the accounts of any person shall be exercised by a police officer below the rank of a Superintendent of Police, unless he is specially authorised in this behalf by a police officer of or above the rank of a Superintendent of Police.

Explanation.—In this section, the expressions “bank” and “bankers’ books” shall have the meanings respectively assigned to them in the Bankers’ Books Evidence Act, 1891 (18 of 1891).

**Compliance defence and mitigation**

The PCA does not provide for mitigation of bribery offences or any de minimis threshold for bribes. As the abetment of bribery is an offence under the PCA, it is generally accepted that the person offering a bribe to a public officer is an accomplice in the offence of accepting illegal gratification.

However, the courts in India have distinguished between different categories of bribe givers based on the intention and the degree of complicity of the bribe giver. For example, the fact that a bribe was offered under a threat of loss or harm may be considered to be a mitigating factor, depending upon the facts and circumstances of each specific case. In order to determine the culpability of the bribe giver, the court will consider the extent and nature of such person’s complicity in the commission of the offence, which may vary having regard to the facts and circumstances of the case. Compliance programs may help prove that a company did not authorise the payment of a bribe.

There is no specific defence in relation to adequate procedures or due diligence.

**Liability of individual directors and officers**

The PCA does not specifically impose liability on directors and officers of a corporate entity for the company’s commission of an offence of corruption. However, as indicated above, the abetment of bribery of public servants is also an offence.

Ordinarily, the director of a company would be liable for offences of the company only when the said director was in charge of the affairs of the company and responsible for the conduct of its business. The Companies Act, 2013 enshrines the concept of an ‘officer in default’ who shall be liable for the acts of the company to any punishment or penalty whether by imprisonment, fine or otherwise, and includes within its ambit whole time directors, key managerial personnel, etc.

An officer in default is specifically held to be liable in cases where such officer is aware of the contravention of the provisions of the legislation by virtue of receipt of any proceedings or any participation without objecting to the same. That said, if such officer is able to establish that he or she acted honestly and reasonably, he or she may be exonerated in certain circumstances.
(B) LOKPAL AND LOKAYUKTA ACT, 2013 (THE LLA)

The Parliament of India also enacted the LLA to constitute a Lokpal for the Union and Lokayukta for States to inquire into allegations of corruption against certain public functionaries. The LLA requires each State to establish a Lokayukta by law under the state legislature. The Lokpal has the jurisdiction to inquire into all complaints arising from the PCA against certain public functionaries, including an incumbent or past Prime Minister, an incumbent or past Union Minister and any person who is or has been a member of Parliament. The LLA provides that after the completion of investigation with respect to a complaint under the PCA, the Lokpal can itself initiate prosecution against the accused and/or impose penalties via its prosecution wing or initiate prosecution in the special court proposed to be established to try offences under the PCA.

Composition of Lokpal

As per the law, Lokpal is a statutory, multi-member body which has no constitutional backing. It consists of one Chairperson and a maximum of 8 members. The Members of Parliament, Members of State Legislative Assembly, Members of Panchayat and Municipality, persons convicted of any offence, politicians, people who are removed from the public services due to their inappropriate actions, persons holding any office of trust or business organization are not eligible to hold the coveted post of Chairperson in Lokpal.

1. Chairperson

A person becomes eligible for the appointment as Chairperson of Lokpal if he is a former Chief Justice of India, a former member of Supreme Court or an eminent person with impeccable integrity and outstanding ability. Additionally, he should have adequate knowledge and 25 years of experience in the matters of the anti-corruption policy, finance, vigilance, law and management, and public administration.

2. Members

Out of 8 permissible members, half will be coming from the judiciary. Rest 50% of members will be from OBC/SC/ST/women and minorities. Judicial members should either be a former Judge of Supreme Court or a former Chief Justice of a High Court. In the case of non-judicial members, they should be eminent persons with impeccable integrity and outstanding ability in their chosen professional areas. They should have at least of 25 years of experience in matters relating to anti-corruption policy, vigilance, public administration, vigilance, law, management, and finance.

Lokpal Officials

There are three officials who work under the anti-corruption ombudsman. The Chairperson appoints them after consulting with other members. They are Secretary to Lokpal and Directors of Inquiry and Prosecution. The Chairperson appoints Secretary from a panel of names suggested by the Central Government. The Chairperson also appoints the Directors of Inquiry and Prosecution. These high-ranking officers cannot be below the rank of Additional Secretary to the Government of India.

Lokpal Wings

According to the Lokpal and Lokayukta Act 2013, the anti-corruption ombudsman would constitute an inquiry wing under the Director of Enquiry. This wing would conduct the preliminary inquiry into an alleged offense committed by a public servant. If convicted, the person is punishable under the Prevention of Corruption Act of 1988. Similarly, the prosecution wing would be constituted under the leadership of the Director of Prosecution. This wing prosecutes the public servants who have been found to commit crime prima facie.
Lokpal's Jurisdiction

As per the law, all public servants come under the purview of the anti-corruption ombudsman. It does not matter whether the public servant was inside or outside the country at the time of the alleged crime. Even the Prime Minister of the country comes under the ambit of the law under certain conditions. Other people who come under the purview of the Lokpal include the Union Ministers, Members of Parliament, Officers coming under Groups A, B, C and D, and persons who are in charge of any society or organization set up by the Central Act or any other body financed or controlled by the Central Government. The persons who get involved in the act of abetting, giving or taking bribe also come under the ambit of the law automatically.

Lokpal Benches

The anti-corruption law proposes to set up the Lokpal benches. The Chairperson constitutes these benches as per his discretion. Ideally, each Lokpal bench will have two or more members. About 50% of the members in each Lokpal Bench should be judicial members. If the bench has the Chairperson, he will oversee it. In cases of benches that don’t have the Chairperson, the judicial member will preside over them. The sitting of these benches may take place in New Delhi or any other place as decided by the Lokpal. Sometimes, the existing benches get re-constituted to get the required output. This would be done by the Chairperson himself if the situation warrants so.

Working of Lokpal

When citizens air their complaints, Lokpal receives them. Then, the anti-corruption ombudsman analyzes them to check their veracity. Once it decides to go ahead, Lokpal would order a preliminary inquiry. This would be done either by the inquiry wing or any other Central Government agency, such as Delhi Special Police Establishment, Central Bureau of Investigation (CBI), etc. The preliminary inquiry has to get completed within 90 days of receiving the complaint. However, the time of inquiry can be extended for further 90 days if the enquiring official requests in writing with sufficient reasons for it. This inquiry would find out whether there is any prima facie case to go ahead. Further recommendations on the case would be done on a case-to-case basis.

1. If the complaints are against officers of Group A to Group D services, the ombudsman would refer it to Central Vigilance Commissioner (CVC) for the follow-up action. CVC would enquire and report the development back to Lokpal directly in case of Group A and Group B officers.

2. CVC would probe and start action against the erring Group C and Group D officers as per the CVC Act of 2005.

Powers of Lokpal

Its inquiry wing has the power to search and seize objects – both movable and immovable objects – and make reports based on them. These reports would be taken up by the 3-member Lokpal benches for further scrutiny. The benches would give the opportunities for the allegedly corrupt officers to say in their defense. After this, the benches would undertake any of the following alternatives.

1. If the officers are found guilty, the benches would grant their sanction to the prosecution wing or CBI to file charge sheets against them. The benches can also direct the concerned government departments to start proceedings against them.

2. If the officers are found innocent, the benches would direct the filing of the closure of case reports before the Special Court. Now, the benches would proceed against the complainants for filing false complaints.
**FOREIGN CORRUPT PRACTICES ACT, 1977 (THE FCPA)**

The idea of Foreign Corrupt Practices Act (FCPA) is to make it illegal for companies and their supervisors to influence foreign officials with any personal payments or rewards. The FCPA applies to any person who has a certain degree of connection to the United States and engages in foreign corrupt practices. The Act also applies to any act by U.S. businesses, foreign corporations trading securities in the U.S., American nationals, citizens, and residents acting in furtherance of a foreign corrupt practice whether or not they are physically present in the U.S. This is considered the nationality principle of the act. Any individuals that are involved in those activities may face prison time.

This act was passed to make it unlawful for certain classes of persons and entities to make payments to foreign government officials to assist in obtaining or retaining business. In the case of foreign natural and legal persons, the Act covers their deeds if they are in the U.S. at the time of the corrupt conduct. This is considered the protective principle of the act. Further, the Act governs not only payments to foreign officials, candidates, and parties, but any other recipient if part of the bribe is ultimately attributable to a foreign official, candidate, or party. These payments are not restricted to monetary forms and may include anything of value. This is considered the territoriality principle of the act.

In simple words, The Foreign Corrupt Practices Act (FCPA), enacted in 1977, generally prohibits the payment of bribes to foreign officials to assist in obtaining or retaining business. The FCPA can apply to prohibited conduct anywhere in the world and extends to publicly traded companies and their officers, directors, employees, stockholders, and agents. Agents can include third party agents, consultants, distributors, joint-venture partners, and others.

The Act concerns the intent of the bribery rather than the amount, there is no requirement of materiality. Offering anything of value as a bribe, whether cash or non-cash items, is prohibited.

The FCPA also requires companies whose securities are listed in the U.S. to meet its accounting provisions. These accounting provisions operate in tandem with the anti-bribery provisions of the FCPA, and require respective corporations to make and keep books and records that accurately and fairly reflect the transactions of the corporation and to devise and maintain an adequate system of internal accounting controls. An increasing number of corporations are taking additional steps to protect their reputation and reduce their exposure by employing the services of due diligence companies tasked with vetting third party intermediaries and identifying easily overlooked government officials embedded in otherwise privately held foreign firms. This strategy is one element of an effective FCPA Compliance Program, as it shows a sincere attempt to avoid business situations where high risk (prior history or proximity to unethical behavior) individuals are concerned.

**CENTRAL VIGILANCE COMMISSION ACT, 2003**

The preamble of the Act provides that it is an Act to provide for the constitution of a Central Vigilance Commission to inquire or cause inquiries to be conducted into offences alleged to have been committed under the Prevention of Corruption Act, 1988 by certain categories of public servants of the Central Government, corporations established by or under any Central Act, Government companies, societies and local authorities owned or controlled by the Central Government and for matters connected therewith or incidental thereto.

The Central Vigilance Commission (CVC) is the body constituted by the Government in the year 1964 on the proposal of the Santharam Committee on the Prevention of Corruption. The body was established with an intention to check corruption in the Government departments. The Commission is an independent statutory body exempted from the authority of the executive. The CVC attained statutory recognition by an ordinance.
of 1998 and in September 12, 2003 the ordinance was replaced by The Central Vigilance Commission Act enacted by the Legislative Department under the Ministry of Law and Justice. The main purpose of the Act was to establish the Central Vigilance Commission to investigate the offences punishable under the Prevention of Corruption Act, 1988 by the public servants working under the Central Government, Corporations constituted under the Act of Parliament, Government companies, and local bodies owned and managed by the Centre.

As provided under the Preamble, the Act entrusts the Central government to constitute the Central Vigilance Commission conferring certain powers and responsibilities and shall continue to function under the Department of Personnel and Training in the Ministry of Personnel, Public Grievances and Pensions. The CVC shall comprise of the Central Vigilance Commissioner acting as the Chairman, maximum two Vigilance Commissioners to be the members, members from the All India Services or Civil Service having special knowledge in the field of vigilance, policy framing and general administration including administration of police service. It shall also consist of members from corporations constituted under the Central legislations or Government Company under the supervision and control of the Centre and person having practice in finance, law, banking, insurance, investigations, vigilance etc. The Central Government is empowered to appoint Secretary to perform certain functions for the Commission.

The President shall appoint the Chairman and the Vigilance Commissioners by warrant under his seal and hand, but according to the advice of the Committee comprising of the Prime Minister acting as the Chairperson, Minister of Home Affairs to be the member and leader of opposition from the Lok Sabha to be another member. The term of office of the Commissioner shall be four years or until he attains the age of 65 years whichever is earlier. The Commissioner and other members shall be removed from his office by an order of the President if proved misbehavior or incapacity by the Supreme Court. The President shall also remove the Chairman and members on any of the following grounds:

- Declared insolvent;
- Condemned to be an offender which involves moral turpitude;
- Engaged in any employment for which he receives remuneration other than his official duties;
- Unfit to perform his duties due to physical or mental infirmity;
- Acquired financial interest which affects his function detrimental to the duties as the Central Vigilance Commissioner or other members.

The Commission is entrusted with certain responsibilities and powers under the Act. The Commission shall supervise the functions of the Delhi Special Police Establishment in connection with the investigation and analysis of offence that comes under the Prevention of Corruption Act of 1988 or the offence committed by a public servant provided under the Criminal Procedure Code. It issues directions and orders to the Delhi Special Police Establishment to discharge the functions assigned to it according to Delhi Special Police Establishment Act, 1946. The Commission shall also inquire and review the developments of the complaints received against any officer for committing an offence under the Prevention of Corruption Act. The Act empowers the Commission to provide guidance to the Central government or the corporations, Government companies or any local bodies on the subjects submitted to it.

While conducting investigation, the Commission shall have the powers of a civil court under the Civil Procedure Code of 1908 and its proceedings are considered to be judicial proceedings under the Indian Penal Code.

of Personnel, Public Grievances and Pensions (Department of Personnel and Training) Resolution, 1999 is repealed by the present Act. In 2004, the Central government formulated the Public Interest Disclosure and Protection of Informer’s Resolution on April 21, which is famously called the Whistle Blowers Resolution which assigned the Commission the duty to keep the identity of the person making the complaint and also to take action against the person making vexatious grievances.

(E) DELHI SPECIAL POLICE ESTABLISHMENT ACT, 1946

The Central Bureau of Investigation traces its origin to the Special Police Establishment (SPE) which was set up in 1941 by the Government of India. The preamble of the Act provides that it is an Act to make provision for the constitution of a special police force in Delhi for the investigation of certain offences in the Union territories for the superintendence and administration of the said force and for the extension to other areas of the powers and jurisdiction of members of the said force in regard to the investigation of the said offences.

The functions of the SPE then were to investigate cases of bribery and corruption in transactions with the War & Supply Deptt. of India during World War II. Even after the end of the War, the need for a Central Government agency to investigate cases of bribery and corruption by Central Government employees was felt. The Delhi Special Police Establishment Act was therefore brought into force in 1946. The CBI’s power to investigate cases is derived from this Act.

As amended by the Central Vigilance Commission Act, 2003 (45 of 2003) [19th November, 1946]

An Act to make provision for the constitution of a special police force in Delhi for the investigation of certain offences in the Union Territories, for the superintendence and administration of the said force and for the extension to other of the powers and jurisdiction of members of the said force in regard to the investigation of the said offences.

Whereas it is necessary to constitute a special police force in Delhi for the investigation of certain offences in the Union territories and to make provision for the superintendence and administration of the said force and for the extension to other areas of the powers and jurisdiction of members of the said force in regard to the investigation of the said offences.

(F) ICSI ANTI BRIBERY CODE

Objective

To ensure that neither the company nor any of its employees, directors or authorised representatives indulge in bribery in any of their actions taken for and on behalf of the company in the course of economic, financial or commercial activities of any kind.

Scope

The Code shall be applicable to the company and its

(i) Board of Directors,
(ii) Employees (full time or part-time or employed through any third party contract),
(iii) Agents, Associates, Consultants, Advisors, Representatives and Intermediaries, and
(iv) Contractors, Sub-contractors and Suppliers of goods and/or services.

Definitions

For the purpose of The Code, unless the context otherwise requires,
'Bribery' includes giving or receiving bribe and third party gratification. The act of giving bribe is when committed intentionally in the course of economic, financial or commercial activities and when it is established that there is a promise, offering or giving, directly or indirectly, of an undue advantage to any person who directs or works, in any capacity, for a commercial entity, for the person himself or for another person, in order that he in breach of his duties, act or refrain from acting.

'Facilitation payment' means a payment made to government or private official that acts as an incentive for the official to complete some action or process expeditiously to the benefit of the party making the payment.

'Foreign public official' means any person holding a legislative, executive, administrative or judicial office of a foreign country, whether appointed or elected, whether permanent or temporary, whether paid or unpaid and includes a person who performs a public function or provides service for a foreign country.

Words and expressions used and not defined in this Code shall have the meaning assigned to them in their respective Acts.

**Clause 1: Adherence to Anti-Corruption Laws**

The company shall follow all anti-corruption laws applicable in India. Clause 2: Bribery in Private Sector

**Clause 2: Bribery in Private Sector**

The company or its employees, directors, agents, associates, consultants, advisors, representatives or intermediaries shall not involve in bribery.

**Clause 3: Facilitation Payments**

No facilitation payment shall be made by the company either directly or through its employees, directors, agents, associates, consultants, advisors, representatives or intermediaries.

**Clause 4: Bribery to Foreign Public Officials**

The company, either directly or through its employees, directors, agents, associates, consultants, advisors, representatives or intermediaries in the conduct of international business shall not offer, promise or give any undue pecuniary or other advantage, to a foreign public official, for that official or for a third party, in order that the official acts or refrains from acting in relation to the performance of official duties, in order to obtain or retain business or other improper advantage.

**Clause 5: Policy for Gifts, Hospitality & Expenses**

The company shall follow a policy for gifts, hospitality and expenses as approved by its Board.

**Clause 6: Whistle Blower Mechanism**

The company shall set up a Whistle Blower Mechanism as approved by its Board to enable its employees or others to raise concerns and report violation(s) of the Code.

**Clause 7: Anti- Bribery Training and Awareness Programmes**

The company shall put in place an annual Corporate Anti-Bribery Code awareness-cum-training program as approved by its Board for all its employees, agent, associates, advisors, representatives, intermediaries, consultants, contractors, sub-contractors and suppliers.

**Clause 8: Monitoring Mechanism for Anti-Bribery Code**

The company shall set up mechanism as approved by its Board for regular monitoring of its Anti- Bribery Code.
Clause 9: Sanctions for Non-compliance

Any non-compliance of the Code is subject to disciplinary mechanism. The company shall set up disciplinary mechanism as approved by its Board, for non-compliance of any part of the Corporate Anti-Bribery Code.

The disciplinary mechanism shall include:

- Nature of offence
- Penalty of the offender
- Competent Authority

Guiding Instructions for Implementation of the Code:

1. Corporate Anti-Bribery Code is to be adopted voluntarily.
2. The Code shall be approved by the Board of Directors of the company. Any change in the Code shall be made with the approval of the Board of the Company.
3. The Code shall be communicated to all existing employees, management and Board members.
4. All the existing employees, management and Board members shall confirm in writing that they shall unconditionally follow the Code in its entirety throughout their employment/association with the company.
5. All the new appointees shall be required to confirm in writing, at the time of their induction in the company that they shall be bound by the Code.
6. All agents, associates, consultants, advisors, all the contractors, sub-contracts and suppliers of goods and/or services, representatives and intermediaries engaged by the company shall also be required to follow the Code while carrying on their assignments for and on behalf of the company at any time during their association with the company. It shall also be made a mandatory condition while confirming their appointment.
7. Anti-Bribery Code of the company shall be put on company’s website. Any change in the Code shall be immediately updated.
8. The Annual Report of the Board shall contain an assertion that the company has an Anti-Bribery Code and the same is being followed by all employees, agents, associates, consultants, advisors, all the contractors, sub-contracts and suppliers of goods and/or services, representatives and intermediaries as well as members of the Board of the company. Any incident of bribery noticed or reported and action taken by the Board shall also be reported.
9. With a view to facilitate the companies, the following model suggested policies which may be adopted by the Board of Directors of the company are annexed to the Code:
   a. Model Policy on Gifts, Hospitality & Expenses
   b. Model Policy on Purchase through Supplier and other Service Provider
   c. Guidelines for Whistle Blower Policy
10. Disclaimer: Due care and diligence is taken in developing the Corporate Anti-Bribery Code. This Code does not substitute or supplant any existing laws. If any of the parameter of this Code are or become inconsistent with the applicable laws, provisions of the related laws shall prevail.

[for more details the students may refer to the ICSI publication on the Corporate Anti-Bribery Code ]
The Act being the Central Government’s enactment was provided with the short title as ‘the Unlawful Activities (Prevention) Act, 1967’ (Act no. 37 of 1967). The same was enacted to make provisions as to more effective prevention of Individual’s and associations’ certain unlawful activities. The Act was amended by the Unlawful Activities (Prevention) Amendment Act, 2004 and also the Amending Act of 2008 for adding in its long title, the object of dealing with the Terrorist Activities. The said amendments were made in pursuance with the Resolutions of the Security Council of the United Nations requiring all the States to take measures and actions against terrorism. The provisions of the Act extended to the whole of India. So far as the applicability of the provisions of the Act to persons are concerned, the section 1 itself says that all persons who commits any act or omission which is contrary to the provisions of this Act, should be held guilty in India, and be punished under this Act. Even commission of such acts or omission contrary to the provisions of this Act out side India, is also to be treated, as the same has been committed in India.

The Act makes its provisions under different seven chapters thereof and from amongst such chapters, the first chapter is making preliminary provisions of the Act, including short title, extension, etc. as aforesaid. Moreover, the second chapter makes provisions as to unlawful associations, wherein section 3 provides for declaration by the Central Government to the effect that any association has become unlawful, however, the Government is also required to specify the grounds on the basis of which it had declared such unlawful association. Moreover, for effecting such declaration a confirmation is required from the Tribunal under section 4 of the Act, where the Tribunal on being provided with the reference, is required to adjudicate the issue of declaration of such unlawful association. Such Tribunal is to be constituted by the Central Government under section 5, with the name and title as ‘Unlawful Activities (Prevention) Tribunal’, which is to have certain powers of the Civil Court under the provisions of Code of Civil Procedure, 1908. Such declaration after its confirmation by the Tribunal, will remain in force for the period of 2 years and the same can be cancelled by the Central Government within that period. The Fund of every such declared unlawful association, if being used by any person under whose custody such fund is there, then the Central Government can make an order prohibiting such person from using such fund. However, if any person feels aggrieved under such order, then he can approached to the Court within the period of 15 days.

The next chapter of the Act makes penal provisions, wherein section 10 as amended by the Amending Act of 2004, provides that if any person from the association after being declared as unlawful under this Act, continues to be a member thereof, takes part in its meetings, makes contribution of any kind for its purposes or otherwise acted in the manner as provided under the provision, then he should be held guilty under the Act, and punishment can extend to life imprisonment and should not be below 5 years imprisonment along with fine. Similarly, the punishment for dealing with funds of the unlawful association is upto 3 years imprisonment and fine also. Besides this, the Act also provides for punishment in respect of contravening the order made in respect of a notified place and also for unlawful activities.

Further, chapter IV of the Act makes provisions for penal provisions as to terrorist activities. Section 15 of the Act defines the terrorist act as an act done with intent to threaten or likely to threaten the unity, integrity, security, etc. of India by using various destructive substances provide under the provision. The punishment for such acts, is death penalty, if the same results in death of any persons and in other cases, the punishment can extend to life imprisonment and minimum 5 years punishment is given. Similarly, there are different punishments provided for other relevant terrorist acts. Further the next chapter is dealing with provisions of forfeiture of the proceeds of terrorism to the Central Government, which no one is entitled to hold. The provision of this chapter was inserted by the Amending Act of 2004.

CHAPTER V of the Act deals with the forfeiture of proceeds of terrorism or any property intended to be used for terrorism: Section 24 provides reference to proceeds of terrorism to include any property intended to be
used for terrorism and section 24A. Deals with the forfeiture of proceeds of terrorism. Powers of investigating officer and Designated Authority and appeal against order of Designated Authority have been mentioned in section 25.

Sections 26 to 34 deals with the issues relating to the Court to order forfeiture of proceeds of terrorism. Issue of show cause notice before forfeiture of proceeds of terrorism, Appeal, Order of forfeiture not to Interfere with other punishments, Claims by third party, Powers of Designated Authority, Certain transfers to be null and void. Forfeiture of property of certain persons, Company to transfer shares to Government.

The chapter VI of the Act makes provisions as to terrorist organization, where the Organisations which are identified as a terrorist one, in the Resolution adopted by the Security Council of UN, should be added to the Schedule of this Act by the Central Government. Similarly, removal of any organisation can also be made by the Central Government under this Act. Also the Act makes association with the Terrorist organisation, taking part in their activities, etc. and even supporting or funding it as the offence under the Act.

At the end portion of the Act i.e. the Chapter VII thereof, the Act makes miscellaneous provisions, wherein the Central Government is empowered to direct delegation of powers to the State Government and such State Government can also with the prior approval from the Centre, direct the delegation of those powers to any person subordinate to it. Further, provisions as to investigation, search, seizure, arrest, etc. have been provided under subsequent provisions to the Act. And finally, the Act also makes other relevant provisions which are also being important so far as the purpose of this Act is concerned.

GLOSSARY OF TECHNICAL WORDS

- **Bribery**: ‘Bribery’ includes giving or receiving bribe and third party gratification. The act of giving bribe is when committed intentionally in the course of economic, financial or commercial activities and when it is established that there is a promise, offering or giving, directly or indirectly, of an undue advantage to any person who directs or works, in any capacity, for a commercial entity, for the person himself or for another person, in order that he in breach of his duties, act or refrain from acting.

- **Facilitation payment**: ‘Facilitation payment’ means a payment made to government or private official that acts as an incentive for the official to complete some action or process expeditiously to the benefit of the party making the payment.

- **Foreign Public Official**: ‘Foreign public official’ means any person holding a legislative, executive, administrative or judicial office of a foreign country, whether appointed or elected, whether permanent or temporary, whether paid or unpaid and includes a person who performs a public function or provides service for a foreign country.

- **PCA**: The **Prevention of Corruption Act**, 1988 is an Act of the Parliament of India enacted to combat **corruption** in government agencies and public sector businesses in India.

- **CVC**: Central Vigilance Commission is an apex Indian governmental body created in 1964 to address governmental corruption. Recently, in 2003, the Parliament enacted a law conferring statutory status on the CVC.

LESSON ROUND-UP

- A change in attitude of enforcement agencies, which have started enforcing anti-corruption laws aggressively in India, and have been supported in their efforts by the judiciary (which has taken up an active role in monitoring corruption cases).

- Corruption has been seen as an immoral and unethical practice since biblical times.

- The cost of implementing an enhanced and extensive anti-corruption compliance program should be
weighed against that of defending a claim due to violation of anticorruption legislation.

- The PCA criminalizes the acceptance of gratification (pecuniary or otherwise) other than the acceptance of legal remuneration by public servants which is paid by their employers in connection with the performance of their duties.

- Due care and diligence is taken in developing the Corporate Anti-Bribery Code. This Code does not substitute or supplant any existing laws. If any of the parameter of this Code are or become inconsistent with the applicable laws, provisions of the related laws shall prevail.

- The LLA requires each State to establish a Lokayukta by law under the state legislature.

- The functions of the SPE then were to investigate cases of bribery and corruption in transactions with the War & Supply Deptt. of India during World War II.

- ‘Facilitation payment’ means a payment made to government or private official that acts as an incentive for the official to complete some action or process expeditiously to the benefit of the party making the payment.

- The Unlawful Activities (Prevention) Act, 1967” (Act no. 37 of 1967) was enacted to make provisions as to more effective prevention of Individual's and associations' certain unlawful activities.

**SELF TEST QUESTIONS**

1. Enumerate the laws and enforcement regimes behind Anti-Corruption and Anti-Bribery Laws in India.


3. What is the composition of the Lokpal?

4. What are the grounds basis which the President can remove the Chairman and members on the board under Central Vigilance Commission Act, 2003?

5. What is the scope of Anti Bribery code as applicable by the ICSI?


7. Define the following terms;
   - Bribery
   - Facilitation payment
   - Foreign public official
PROFESSIONAL PROGRAMME
GOVERNANCE, RISK MANAGEMENT, COMPLIANCES AND ETHICS

PP-GRCE

A Guide to CS Students

To enable the students in achieving their goal to become successful professionals, Institute has prepared a booklet ‘A Guide to CS Students” to provide them with the subject specific guidance on different papers and subjects contained in the ICSI curriculum. The booklet is available on ICSI website and students may download it from http://www.icsi.edu/Portals/0/AGUIDETOCSSTUDENTS.pdf

WARNING

It is brought to the notice of all students that use of any malpractice in Examination is misconduct as provided in the explanation to Regulation 27 and accordingly the registration of such students is liable to be cancelled or terminated. The text of regulation 27 is reproduced below for information:

“27. Suspension and cancellation of examination results or registration

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or the Committee concerned may suo motu or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity to state his case, suspend or debar the person from appearing in any one or more examinations, cancel his examination result, or studentship registration, or debar him from future registration as a student, as the case may be.

Explanation - Misconduct for the purpose of this regulation shall mean and include behaviour in a disorderly manner in relation to the Institute or in or near an Examination premises/centre, breach of any regulation, condition, guideline or direction laid down by the Institute, malpractices with regard to postal or oral tuition or resorting to or attempting to resort to unfair means in connection with the writing of any examination conducted by the Institute”.
PROFESSIONAL PROGRAMME
GOVERNANCE, RISK MANAGEMENT, COMPLIANCES AND ETHICS

TEST PAPER
(This Test Paper is for recapitulate and practice for the student. Student need not submit responses/Answers to this Test Paper)
Time Allowed: 3 hours
Maximum Marks: 100

PART - I

1. (a) “Good corporates are not born, but are made by the combined efforts of all stakeholders, board of directors, government and the society at large.” In the light of this statement discuss the principles of good corporate governance. (10 marks)

(b) During a Board meeting of ABC Ltd., some of the directors who were dissatisfied with the Chairman on various issues, proposes his removal, which was acceded to by majority of directors at the meeting.

Taking the facts into consideration, answer the following:

(i) Being a Company Secretary you were requested to give your views on such removal of chairman and guide the board members about the legal provisions, procedures and processes to be followed in this matter. (7 marks)

(ii) Being an independent director, what course of action would you like to opt in such circumstances? (3 marks)

(c) Enumerate various committees of the Board of directors which are required to be mandatorily constituted under the Companies Act, 2013 and state their functions? (5 marks)

Attest all parts of either Question No. 2 or Question No. 2A

Question 2

2. (a) “Independent directors are known to bring an objective view in Board deliberations. They act as guardians of the interest of all stakeholders, especially in the areas of potential conflicts.” In the light of this statement discuss the role of independent directors in a company.

(b) The Board of ABC Ltd. wishes to establish a vigil mechanism in the company. As a Company Secretary, guide company on the legal framework under the Companies Act, 2013.

(c) “The institutional investors use different tools to assess the health of a company before investing resources in it.” Elaborate. (5 marks each)

Or (Alternate question to Q. No. 2)

2A. Discuss in brief the following:

(a) Principles for periodic disclosures

(b) Science, Technology & Sustainability Committee

(c) Performance evaluation of Independent Director
(d) Class Action Suit
(e) King IV report on Corporate Governance

3. (a) You are company secretary of an insurance company. The Board of Directors of your company requires you to draw up a policy based on the principles spelt out in the Stewardship Code for Insurers in India.

(b) In order to ensure good governance, Companies (Meetings of Board and its Powers) Rules, 2014 specifies certain matters not to be dealt with in a meeting through Video Conferencing or other Audio Visual Means. What are these matters?

PART - II

Attempt all parts of either Question No. 4 or Question No. 4A

4. (a) “Risk is inherent in every business, whether it be of financial nature or non-financial nature.” Explain.

(b) What do you understand by Fraud Risk Management? Discuss the role of Company Secretary in Risk Management.

(c) Explain risk mitigation strategies.

(d) Elaborate on the classification of risk.

Or (Alternate question to Q. No. 4)

4A. Discuss in brief the following:

(a) SWOT Analysis
(b) Risk Identification
(c) Principles on risk oversight
(d) Standard on implementation of Risk Management

PART - III

Attempt all parts of either Question No. 5 or Question No. 5A

5. (a) Discuss the significance of Compliance and the essentials of an effective compliance program.

Discuss the Internal Compliance Reporting Mechanism (ICRM).

Write a brief note on COSO’s Internal Control Framework

Discuss the limitations of financial reporting

OR (Alternate question to Q. No. 5)

5A Discuss the role of Company Secretaries in Compliance Management.

(a) Write a note on the roles and responsibilities of Internal Control System.
(b) Write in brief the elements of internal control.

(c) You are Company Secretary of XYZ Limited. You are required by the Chairman of your company to prepare a note for the Board of directors highlighting the benefits of integrated reporting.  

PART - IV

Attempt all parts of either Question No.6 or Question No. 6A

6. (a) Your Company is planning to bring out the sustainability report. As a company secretary prepare a note for the Board of Directors highlighting the importance of Sustainability Reporting and the available framework.

(b) Write a note on context and relevance of business ethics.  

OR (Alternate question to Q. No. 6)

6A. Discuss in brief the following:

(a) Code of Ethics

(b) Global Compact Self Assessment Tool

(c) Dow-Jones Sustainability Index

(d) Altman Z-Score

(e) Powers of Lokpal

(2 marks each)