RELEVANT FOR DECEMBER, 2019 SESSION ONWARDS

STUDY MATERIAL

PROFESSIONAL PROGRAMME

GOVERNANCE, RISK MANAGEMENT, COMPLIANCES AND ETHICS

MODULE I
PAPER 1

THE INSTITUTE OF
Company Secretaries of India
भारतीय कम्पनी सचिव संस्थान
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament
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Laser Typesetting by AArushi Graphics, Prashant Vihar, New Delhi, and
Printed at M P Printers/June 2019

PROFESSIONAL PROGRAMME

GOVERNANCE, RISK MANAGEMENT, COMPLIANCES AND ETHICS

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 especially looks upon 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 June, 2019 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 updations 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.

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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 is 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 has 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 and sustainable development.

PROFESSIONAL PROGRAMME

MODULE 1

PAPER 1

GOVERNANCE, RISK MANAGEMENT, COMPLIANCES AND ETHICS

(100 MARKS)

SYLLABUS

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)

1. **Conceptual Framework of Corporate Governance**: Introduction, Need and Scope, Evolution of Corporate Governance, Management vs. Ownership, Majority vs Minority, Corporate Governance codes in major jurisdictions, Sarbanes Oxley Act, US Securities and Exchange Commission; OECD Principles of Corporate Governance; Developments in India, Corporate Governance in Indian Ethos, Corporate Governance – Contemporary Developments.
2. **Legislative Framework of Corporate Governance in India**: Listed Companies, Unlisted Companies, PSUs, Banks and Insurance Companies.
3. **Board Effectiveness**: Composition and Structure, Duties and Liabilities, Evolution of Jurisprudence, Diversity in Board Room, Women Director, Nominee Directors; Selection and Appointment Process, Independent Directors: expectations, liabilities and their role, code of conduct, responsibilities and effectiveness.
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.
7. **Directors' Training, Development and familiarisation.**

8. **Performance Evaluation of Board and Management**: Evaluation of the performance of the Board as a whole, individual director (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.**
12. **Related Party Transactions.**
13. **Vigil Mechanism/Whistle blower.**
14. **Corporate Governance and Shareholders' Rights.**
15. **Corporate Governance and other Stakeholders**: Employees, Customers, Lenders, Vendors, Government and Regulators, Society, etc.
16. **Governance and Compliance Risk**: Governance/Compliance failure and their impact on business, reputation and fund raising.
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)

21. **Risk Identification, Mitigation and Audit**: Risk Identification, Risk Analysis, Risk Measurement, Risk Mitigation, Risk Elimination, Risk Management Committee, Clarification and Investigation, Role of Internal Audit, Risk Audit, Risk Related Disclosures.

    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.
23. **Internal Control**: Nature, Scope and Elements, Techniques of Internal Control System, Steps for Internal Control, Efficacy of internal controls and its review.
24. **Reporting**: Integrated Reporting, Non-financial Reporting, Corporate Sustainability Reporting, Board Reporting, Annual Report, Other Reports under LODR, PIT, SAST Regulations.
25. **Website Management**: Meeting through Video Conferencing.

    Case Studies & Practical Aspects

Part IV: Ethics & Sustainability (10 Marks)

26. **Ethics & Business**: Ethics, Business Ethics, Organization Structure and Ethics, Addressing Ethical Dilemmas, Code of Ethics, Indian Ethos, Designing Code of Conduct, Policies, Fair practices and frameworks.

27. **Sustainability**: Corporate Social Responsibility, Corporate Sustainability Reporting Framework, Legal Framework, Conventions, Treaties on Environmental and Social Aspects, Triple Bottom Line, Principle of Absolute Liability - Case Studies, Contemporary Developments, Indian Ethos.

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.

29. **Indian and contemporary Laws relating to Anti-bribery**: Prevention of corruption Act,1988, Central Vigilance Commission Act, 2003, Lokpal & Lokayukta Act, 2013, Foreign Corrupt Practices Act, 1977, Unlawful Activities (Prevention) Act, 1967 & Delhi Special Police Establishment Act, 1946; ICSI Anti Bribery Code.

Case Studies & Practical Aspects

ARRANGEMENT OF STUDY LESSONS

MODULE 1 – PAPER 1

GOVERNANCE, RISK MANAGEMENT, COMPLIANCES AND ETHICS

LESSON WISE SUMMARY

GOVERNANCE, RISK MANAGEMENT, COMPLIANCES AND ETHICS

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.

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

The Companies Act, 2013 which envisages radical changes in the sphere of Corporate Governance in India along with SEBI LODR Regulations, 2015 provide for various provisions for good governance of companies. The Companies Act, 2013 is applicable to all companies registered under the Act and listed companies have to follow SEBI Regulations also. 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 Companies, Banks and NBFCs. Also details the guidelines for the insurance companies. Stewardship Code for insurers in India has also been explained. It also provides overview of the governance of Public Sector Enterprises under DPE Guidelines.

Lesson 3: Board Effectiveness

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.

Therefore in this Lesson Board's role, powers and duties, types of directors required to be appointed under the laws, board composition and role of independent director in ensuring board effectiveness have been discussed.

The lesson also gives an insight on training of directors and performance evaluation of directors.

Lesson 4: Board Processes through Secretarial Standards

In general, board process refers mainly to the decision-making activities of the board which need to be performed so that the objectives of the board can be achieved. 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.

The fundamental principles with respect to Board Meetings are laid down in the Companies Act, 2013 and the Secretarial Standard -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.

In this lesson, effective working of Boards through Secretarial Standard- 1 has been discussed.

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 Policies and Disclosures

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 discusses about various disclosure and transparency requirements under Companies Act 2013 and SEBI Regulations.

Various disclosures mandatorily required by the companies and listed entities are also elaborated in detail in this chapter.

Lesson 7: Accounting and Audit related issues, RPTs and Vigil Mechanism

Corporate Governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society.

Good accounting and auditing practices are highly effective as an instrument of corporate governance. Companies Act 2013 has provided for various mandatory and voluntary practices to improve financial reporting, internal audit and statutory audit of companies in India. Keeping this in view, this study lesson covers various good governance initiatives taken by the government of our country for accounting and audit related issues.

It also covers in brief various legal provisions as well as background to related party transactions, meaning of related parties, transactions covered under RPT and the procedure for approval etc.

At the end, lesson provides brief about vigil mechanism, background of whistle blower concept and various laws pertaining to it.

Lesson 8 : 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 9: 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 10: 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 11: 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 12: 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 13: 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 14: 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 15: Reporting

Reporting may mean to provide the information to the stake holders 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.

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 which is like "looking in the rear-view mirror."

This has led to the development of contemporary means of reporting like CSR reporting, reporting of business sustainability and the most recent development is integrated reporting.

In this study lesson reporting requirements for a company under the laws and some best practices have been discussed. The lesson highlights requirements for Board's report, CSR Report, BRR and the framework for integrated reporting.

Lesson 16: Ethics and Business

Ethics is a "Science of morals." 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.

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 17: CSR and 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.

Sustainability is an emerging mega trend that focuses on business 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.

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 lesson also highlights the importance of sustainable development and important global treaties on environmental and social aspects.

The various models and approaches used for measuring the business sustainability which will guide the students to understand the models and approaches used for measuring the business sustainability are also discussed.

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.

LIST OF RECOMMENDED BOOKS

PAPER 1 – GOVERNANCE, RISK MANAGEMENT, COMPLIANCE AND ETHICS

READINGS

1. Corporate Governance, Principles, policies and Practices – A.C. Fernando, Pearson Education
2. Business, Ethics and Corporate Governance - A.C. Fernando, Pearson Education
3. Corporate Governance – IICA, Taxmann
4. Business Ethics- Concepts and Cases – Manuel G. Velasquez
5. The Art of Corporate Governance – Dr. Joffy George
6. **Journals** – (a) ICSI – Chartered Secretary

   (b) ICSI – Student Company Secretary – E-bulletin
7. Companies Act, 2013 and Rules
8. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

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LEGISLATIVE FRAMEWORK OF CORPORATE GOVERNANCE IN INDIA

LESSON 5

BOARD COMMITTEES

LESSON 6

CORPORATE POLICIES AND DISCLOSURES

LESSON 9

CORPORATE GOVERNANCE AND OTHER STAKEHOLDERS

LESSON 10
GOVERNANCE AND COMPLIANCE RISK

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ETHICS AND BUSINESS

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LESSON 18

ANTI-CORRUPTION AND ANTI-BRIBERY LAWS IN INDIA

Lesson 1

Conceptual Framework of Corporate Governance

LESSON OUTLINE

- Meaning and Definitions of Corporate Governance
- Need for Corporate Governance
- Elements/Scope of Corporate Governance
- Evolution of Corporate Governance
  - Theories of Corporate Governance
  - Concept of Management vs. Ownership
  - Concept of Majority vs. Minority
- History of development of Corporate Governance
  - Stages of Development of corporate governance in USA
  - Development of corporate governance in UK
- Corporate Governance Codes in Major Jurisdictions of the world
- OECD Principles of Corporate Governance
- Roots of Corporate Governance in Indian Ethos
- Corporate Governance in India-Contemporary Developments
- 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.***

MEANING AND DEFINITIONS OF CORPORATE GOVERNANCE

Corporate Governance is "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."

Noble Laureate Milton Friedman

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. The root of the word Governance is from 'gubernate', which means to steer. 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.

The phrase "corporate governance" describes "the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled within corporations. It encompasses the mechanisms by which companies, and those in control, are held to account."

Corporate governance is the broad term used to describe the processes, customs, policies, laws and institutions that direct the organizations and corporations in the way they act or administer and control their operations. It works to achieve the goal of the organization and manages the relationship among the stakeholders including the board of directors and the shareholders.

Corporate governance means to steer an organization in the desired direction by determining ways to take effective strategic decisions. It also deals with the accountability of the individuals through a mechanism which reduces the principal-agent problem in the organization.

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.

Good corporate governance promotes investor confidence, which is crucial to the ability of entities listed to compete for capital. Good 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.

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

"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**
"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**
"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." **Report of N.R. Narayana Murthy Committee on Corporate Governance constituted by SEBI (2003)**
"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)**
"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." **Confederation of Indian Industry (CII) – Desirable Corporate Governance Code (1998)**

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 upto 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 / SCOPE 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 primary 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 d.ay-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.

EVOLUTION OF CORPORATE GOVERNANCE

The following theories elucidate the basis of evolution of corporate governance:

(a) Agency Theory

(b) Shareholder Theory

(c) Stake Holder Theory

(d) Stewardship Theory

(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 mangers 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) Stockholder/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 mangers 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 stake holders 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 stake holders. 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.

CONCEPT OF 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.

CONCEPT OF MAJORITY RULE VS. MINORITY INTEREST

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.

HISTORY OF DEVELOPMENT OF CORPORATE GOVERNANCE

After World War II, the United States experienced strong economic growth, which had a strong impact on the history of corporate governance. Corporations were thriving and growing rapidly. In the 1970s, the Securities and Exchange Commission (SEC) brought the issue of corporate governance to the forefront when they brought a stance on official corporate governance reforms. In 1976, the term “corporate governance” first appeared in the Federal Register, the official journal of the federal government.

Stages of development of Corporate Governance in USA	
Years	**Developments**
1977 The Foreign Corrupt Practices Act	Provides for specific provisions regarding establishment, maintenance and review of systems of internal control.
1979 US Securities Exchange Commission	Prescribed mandatory reporting on internal financial controls.
1985 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.
1992 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”.

2002 Sarbanes – Oxley Act	The Act made fundamental changes in virtually every aspect of corporate governance in general and auditor independence, conflict 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	The Dodd-Frank Act is legislation signed into law by President Barack Obama in 2010 in response to the financial crisis that became known as the Great Recession. Dodd-Frank put regulations on the financial industry and created programs to stop mortgage companies and lenders from taking advantage of consumers. The Dodd-Frank Act is a comprehensive and complex bill that contains 16 major areas of reform. The law places strict regulations on lenders and banks in an effort to protect consumers and prevent another all-out economic recession. Dodd-Frank also created several new agencies to oversee the regulatory process and implement certain changes. Some of the main provisions found in the Dodd-Frank Act include: ● Banks are required to come up with plans for a quick shutdown if they approach bankruptcy or run out of money. ● Financial institutions must increase the amount of money they hold in reserve to account for potential future slumps. ● Every bank with more than $50 billion of assets must take an annual “stress test,” given by the Federal Reserve, which can help determine if the institution could survive a financial crisis. ● The Financial Stability Oversight Council (FSOC) identifies risks that affect the financial industry and keeps large banks in check. ● The Consumer Financial Protection Bureau (CFPB) protects consumers from the corrupt business practices of banks. This agency works with bank regulators to stop risky lending and other practices that could hurt American consumers. It also oversees credit and debit agencies as well as certain payday and consumer loans. ● The Office of Credit Ratings ensures that agencies provide reliable credit ratings to those they evaluate. ● A whistle-blowing provision in the law encourages anyone with information about violations to report it to the government for a financial reward.

Development of Corporate Governance in UK	
1992 Cadbury Report	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. 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.
1998 Hampel Report	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.

1998 Combined Code 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; and ● all kinds of remuneration including pensions should be disclosed.
1999 Turnbull Report	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"**.
2001 Myners : Review of Institutional Investment	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.
2003 Higgs Report	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; ● that the non-executives should meet at least once a year in isolation to discuss company performance; ● that a senior independent director be nominated and made available for shareholders to express any concerns to; and ● that potential non-executive directors should satisfy themselves that they possess ● the knowledge, experience, skills and time to carry out their duties with due diligence.
2003	The Financial Reporting Council published the Smith Report, "Guidance on Audit Committees"**.** The Tyson Report on the recruitment and development of non-executive directors commissioned by the Department of Trade and Industry.

2009 Walker Review of Corporate Governance of UK Banking Industry	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."*
2011 Sharman Inquiry	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.
2010 - 2012 Stewardship Code	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 was 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.
2003 - 2016 Revision of Combined Code on Corporate Governance	● Recommendations of Higgs Report, Smith Report & Tyson Report relating to role and effectiveness of non-executive directors, audit committee and recruitment & development of non-executive directors, provided recommendations for the revised combined code in 2003. ● 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. ● 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. ● The revised Code (2016) is also based on the Comply - or – explain approach and has set standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders. 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.
2018 – New 2018 UK Corporate Governance Code	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, 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 Financial Reporting Council (FRC) published its new 2018 UK Corporate Governance Code (2018 Code) on July 16, 2018, together with revised Guidance on Board Effectiveness (Guidance) which supplements the 2018 Code by suggesting good practice to assist companies in applying the 2018 Code's Principles and reporting on that application. The 2018 Code sets higher standards of corporate governance in the UK so as to promote transparency and integrity in business and, at the same time, attract investment in the UK in the long-term, benefitting the economy and wider society. The 2018 Code emphasises the importance of positive relationships between companies, shareholders and stakeholders, a clear purpose and strategy aligned with healthy corporate culture, high quality board composition and a focus on diversity, and remuneration which is proportionate and supports long-term success.

CORPORATE GOVERNANCE CODES IN MAJOR JURISDICTIONS ACROSS THE WORLD

Corporate governance is a critical factor in economic stability and organisational success. In the last few decades, 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 countries like USA, UK, Australia, Singapore and South Africa are discussed below.

Corporate Governance Framework in USA

The companies in U.S are governed by a variety of legal regimes relating to corporate governance matters. These consist of state laws and federal statutory rules and regulations of various government agencies including rules promulgated by U.S. Securities and Exchange Commission (the SEC) and self regulatory organizations such as stock exchanges that impose requirements on companies whose securities are listed on such stock exchanges.

The primary sources of federal rules and regulations include the Securities Act of 1933 and the Securities Exchange Act of 1934 and the regulations framed under those Acts.

Other regulations imposing disclosure and compliance requirements include the Sarbanes Oxley Act of 2002 and the Dodd-Frank Wall Street reform and Consumer Protection Act of 2010.

Also, major stock exchanges like NYSE and NASDAQ provides for the rules pertaining to corporate governance matters which companies must comply as a condition to being listed on the stock exchange.

U.S. Securities and Exchange Commission: The aim of U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. The SEC oversees the key participants in the securities world, including securities exchanges, securities brokers and dealers, investment advisors, and mutual funds. The SEC is concerned primarily with promoting the disclosure of important market-related information, maintaining fair dealing, and protecting against fraud.

The laws and rules that govern the securities industry in the United States derive from a simple and straightforward concept: all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it. To achieve this, the SEC requires public companies to disclose meaningful financial and other information to the public. This provides a common pool of knowledge for all investors to use to judge for themselves whether to buy, sell, or hold a particular security. Only through the steady flow of timely, comprehensive, and accurate information can people make sound investment decisions.

The SEC is the primary overseer and regulator of the U.S. securities markets. It works closely with many other institutions, including Congress, other federal departments and agencies, the self-regulatory organizations (e.g. the stock exchanges), state securities regulators, and various private sector organizations. In addition, the Chairman of the SEC represents the agency as a member of the Financial Stability Oversight Council (FSOC).

Sarbanes-Oxley Act of 2002

In 2002, the United States Congress passed the Sarbanes-Oxley Act (SOX) to protect shareholders and the general public from accounting errors and fraudulent practices in enterprises, and to improve the accuracy of corporate disclosures. Congressmen Paul Sarbanes and Michael Oxley drafted the act with the goal of improving corporate governance and accountability, in light of the financial scandals that occurred at Enron, WorldCom, and Tyco, among others.

The act sets deadlines for compliance and publishes rules on requirements. The Act mandated a number of reforms to enhance corporate responsibility, enhance financial disclosures and combat corporate and accounting fraud, and also created the "Public Company Accounting Oversight Board," also known as the PCAOB, to oversee the activities of the auditing profession. The Act became effective since 2006 for all publicly-traded companies which are required to implement and report to the SEC for compliance. In addition, certain provisions of Sarbanes-Oxley also apply to privately-held companies.

The summary highlights of the most important Sarbanes-Oxley sections for compliance are listed below.

SOX Section 302 – **Corporate Responsibility for Financial Reports**	a) CEO and CFO must review all financial reports. b) Financial report does not contain any misrepresentations. c) Information in the financial report is "fairly presented". d) CEO and CFO are responsible for the internal accounting controls. e) CEO and CFO must report any deficiencies in internal accounting controls, or any fraud involving the management of the audit committee. f) CEO and CFO must indicate any material changes in internal accounting controls.
SOX Section 401: **Disclosures in Periodic Reports**	All financial statements and their requirement to be accurate and presented in a manner that does not contain incorrect statements or admit to state material information. Such financial statements should also include all material off-balance sheet liabilities, obligations, and transactions.
SOX Section 404: **Management Assessment of Internal Controls**	All annual financial reports must include an Internal Control Report stating that management is responsible for an "adequate" internal control structure, and an assessment by management of the effectiveness of the control structure. Any shortcomings in these controls must also be reported. In addition, registered external auditors must attest to the accuracy of the company management's assertion that internal accounting controls are in place, operational and effective.
SOX Section 409: **Real Time Issuer Disclosures**	Companies are required to disclose on a almost real-time basis information concerning material changes in its financial condition or operations.
SOX Section 802 **Criminal Penalties for Altering Documents**	This section specifies the penalties for knowingly altering documents in an ongoing legal investigation, audit, or bankruptcy proceeding.
SOX Section 806 – **Protection for Employees of Publicly Traded Companies Who Provide Evidence of Fraud**	This section deals with whistleblower protection.

SOX Section 902 – **Attempts & Conspiracies to Commit Fraud Offenses**	It is a crime for any person to corruptly alter, destroy, mutilate, or conceal any document with the intent to impair the object's integrity or availability for use in an official proceeding.
SOX Section 906 – **Corporate Responsibility for Financial Reports**	Section 906 addresses criminal penalties for certifying a misleading or fraudulent financial report. Under SOX 906, penalties can be upwards of $5 million in fines and 20 years in prison.

UK Corporate Governance Code, 2018

The Financial Reporting Council (FRC), an independent regulator in the UK and Ireland, is responsible for regulating auditors, accountants and actuaries and promotes transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries.

The FRC published its new **2018 UK Corporate Governance Code (2018 Code)** on July 16, 2018, together with **revised Guidance on Board Effectiveness** which supplements the 2018 Code by suggesting good practice to assist companies in applying the 2018 Code's Principles and reporting on that application.

The Code is applicable to all companies with a premium listing, whether incorporated in the UK or elsewhere. The new Code applies to accounting periods beginning on or after 1 January 2019.

The 2018 Code sets out the principles by which the board of directors should promote the purpose, values and future success of the company. The Code sets out standards of good practice in relation to issues such as leadership, effectiveness, accountability, remuneration, and relations with shareholders. The Code does not set out a rigid set of rules; instead it offers flexibility through the application of Principles and through 'comply or explain' Provisions and supporting guidance. It is the responsibility of boards to use this flexibility wisely and of investors and their advisors to assess differing company approaches thoughtfully.

The Listing Rules require companies to explain how they have applied the main principles of the Code and the extent to which they have complied with the detailed provisions. The main principles provided in the code are given hereunder.

Heading	Principles
BOARD LEADERSHIP AND COMPANY PURPOSE	A. A successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society. B. The board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the desired culture. C. The board should ensure that the necessary resources are in place for the company to meet its objectives and measure performance against them. The board should also establish a framework of prudent and effective controls, which enable risk to be assessed and managed.

	D. In order for the company to meet its responsibilities to shareholders and stakeholders, the board should ensure effective engagement with, and encourage participation from, these parties. E. The board should ensure that workforce policies and practices are consistent with the company's values and support its long-term sustainable success. The workforce should be able to raise any matters of concern.
DIVISION OF RESPONSIBILITIES	F. The chair leads the board and is responsible for its overall effectiveness in directing the company. They should demonstrate objective judgement throughout their tenure and promote a culture of openness and debate. In addition, the chair facilitates constructive board relations and the effective contribution of all non-executive directors, and ensures that directors receive accurate, timely and clear information. G. The board should include an appropriate combination of executive and non-executive (and, in particular, independent non-executive) directors, such that no one individual or small group of individuals dominates the board's decision-making. There should be a clear division of responsibilities between the leadership of the board and the executive leadership of the company's business. H. Non-executive directors should have sufficient time to meet their board responsibilities. They should provide constructive challenge, strategic guidance, offer specialist advice and hold management to account. I. The board, supported by the company secretary, should ensure that it has the policies, processes, information, time and resources it needs in order to function effectively and efficiently.
COMPOSITION, SUCCESSION AND EVALUATION	J. Appointments to the board should be subject to a formal, rigorous and transparent procedure, and an effective succession plan should be maintained for board and senior management.4 Both appointments and succession plans should be based on merit and objective criteria5 and, within this context, should promote diversity of gender, social and ethnic backgrounds, cognitive and personal strengths. K. The board and its committees should have a combination of skills, experience and knowledge. Consideration should be given to the length of service of the board as a whole and membership regularly refreshed. L. Annual evaluation of the board should consider its composition, diversity and how effectively members work together to achieve objectives. Individual evaluation should demonstrate whether each director continues to contribute effectively

AUDIT, RISK AND INTERNAL CONTROL	M. The board should establish formal and transparent policies and procedures to ensure the independence and effectiveness of internal and external audit functions and satisfy itself on the integrity of financial and narrative statements. N. The board should present a fair, balanced and understandable assessment of the company's position and prospects. O. The board should establish procedures to manage risk, oversee the internal control framework, and determine the nature and extent of the principal risks the company is willing to take in order to achieve its long-term strategic objectives.
REMUNERATION	P. Remuneration policies and practices should be designed to support strategy and promote long-term sustainable success. Executive remuneration should be aligned to company purpose and values, and be clearly linked to the successful delivery of the company's long-term strategy. Q. A formal and transparent procedure for developing policy on executive remuneration and determining director and senior management10 remuneration should be established. No director should be involved in deciding their own remuneration outcome. R. Directors should exercise independent judgement and discretion when authorising remuneration outcomes, taking account of company and individual performance, and wider circumstances.

Corporate Governance Principles and Recommendations, Australia -2019

The ASX Corporate Governance Council ("Council"), convened in August 2002 is the organisation which brings together various business, shareholder and industry groups, each offering valuable insights and expertise on governance issues from the perspective of their particular stakeholders. Its primary work has been the development of the Principles and Recommendations.

The Corporate Governance Principles and Recommendations ("Principles and Recommendations") were first introduced in 2003. A second edition was published in 2007 and a third in 2014. In 2017, the Council agreed that it was an appropriate time to commence work on a fourth edition of the Principles and Recommendations to address emerging issues around culture, values and trust, fuelled by recent examples of conduct by some listed entities falling short of community standards and expectations.

The fourth edition comes into force for financial years commencing on or after 1 January 2020.

These Principles and Recommendations set out recommended corporate governance practices for entities admitted to the ASX official list as an ASX listing, regardless of the legal form they take, whether they are established in Australia or elsewhere, and whether they are internally or externally managed. The Principles and Recommendations are not mandatory and do not seek to prescribe the corporate governance practices that a listed entity must adopt.

The "if not, why not" approach is fundamental to the operation of the Principles and Recommendations. This approach ensures that the market receives an appropriate level of information about the entity's governance arrangements so that investors and other stakeholders can have a meaningful dialogue with the board and management on governance matters and can factor the information provided into their decision on whether or not to invest in the entity and how to vote on particular resolutions.

The Principles and Recommendations are structured around, and seek to promote, 8 central principles. There are 35 specific recommendations of general application intended to give effect to these principles, as well as 3 additional recommendations that only apply in certain limited cases.

8 Central Principles

1. Lay solid foundations for management and oversight: A listed entity should clearly delineate the respective roles and responsibilities of its board and management and regularly review their performance.
2. Structure the board to be effective and add value: The board of a listed entity should be of an appropriate size and collectively have the skills, commitment and knowledge of the entity and the industry in which it operates, to enable it to discharge its duties effectively and to add value.
3. Instil a culture of acting lawfully, ethically and responsibly: A listed entity should instil and continually reinforce a culture across the organisation of acting lawfully, ethically and responsibly.
4. Safeguard the integrity of corporate reports: A listed entity should have appropriate processes to verify the integrity of its corporate reports.
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.
6. Respect the rights of security holders: A listed entity should provide its security holders with appropriate information and facilities to allow them to exercise their rights as security holders effectively.
7. Recognise and manage risk: A listed entity should establish a sound risk management framework and periodically review the effectiveness of that framework.
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 and with the entity's values and risk appetite.

Code of Corporate Governance, Singapore - 2018

The Code of Corporate Governance (the "Code"), which is applicable to listed companies in Singapore on a comply-or-explain basis, first came into effect on 1 January 2003.

On August 6, the Monetary Authority of Singapore ("MAS") announced the adoption of a new Code of Corporate Governance (the "Code") along with the new Practice Guidance. The new Code comes after MAS conducted a public consultation on changes to Singaporean corporate governance practices.

The Code will initially take effect for companies with a financial year beginning January 1, 2019, concurrent with changes to Singapore Exchange Limited ("SGX") Listing Rules, however some of the changes will not be phased in until 2022.

The Code aims to promote high levels of corporate governance in Singapore by putting forth Principles of good corporate governance and Provisions with which companies are expected to comply. The Practice Guidance complements the Code by providing guidance on the application of the Principles and Provisions and setting out best practices for companies. Adoption of the Practice Guidance is voluntary.

This version of the Code has at its core broad Principles of corporate governance. Compliance with, and observation of, these Principles is mandatory. These Principles set out broadly accepted characteristics of good corporate governance. Companies are required to describe their corporate governance practices with reference to both the Principles and Provisions, and how the company's practices conform to the Principles.

The emphasis of the Code is for companies to provide thoughtful and meaningful explanations around their practices, and for investors to carefully consider these discussions as part of their engagements with companies. Frank and informed dialogue between companies and their shareholders is a central tenet of good corporate governance, and encourages more active stewardship. Better engagement between these parties will benefit the company and investors.

Principles

1. The company is headed by an effective Board which is collectively responsible and works with Management for the long-term success of the company.
2. The Board has an appropriate level of independence and diversity of thought and background in its composition to enable it to make decisions in the best interests of the company.
3. There is a clear division of responsibilities between the leadership of the Board and Management, and no one individual has unfettered powers of decision-making.
4. The Board has a formal and transparent process for the appointment and reappointment of directors, taking into account the need for progressive renewal of the Board.
5. The Board undertakes a formal annual assessment of its effectiveness as a whole, and that of each of its board committees and individual directors.
6. The Board has a formal and transparent procedure for developing policies on director and executive remuneration, and for fixing the remuneration packages of individual directors and key management personnel. No director is involved in deciding his or her own remuneration.
7. The level and structure of remuneration of the Board and key management personnel are appropriate and proportionate to the sustained performance and value creation of the company, taking into account the strategic objectives of the company.
8. The company is transparent on its remuneration policies, level and mix of remuneration, the procedure for setting remuneration, and the relationships between remuneration, performance and value creation.
9. The Board is responsible for the governance of risk and ensures that Management maintains a sound system of risk management and internal controls, to safeguard the interests of the company and its shareholders.
10. The Board has an Audit Committee (“AC”) which discharges its duties objectively.
11. The company treats all shareholders fairly and equitably in order to enable them to exercise shareholders’ rights and have the opportunity to communicate their views on matters affecting the company. The company gives shareholders a balanced and understandable assessment of its performance, position and prospects.
12. The company communicates regularly with its shareholders and facilitates the participation of shareholders during general meetings and other dialogues to allow shareholders to communicate their views on various matters affecting the company.
13. The Board adopts an inclusive approach by considering and balancing the needs and interests of material stakeholders, as part of its overall responsibility to ensure that the best interests of the company are served.

King IV Report on Corporate Governance, South Africa – 2016

The King Committee, a private-sector body comprising of former South African Supreme Court Judge, Mervyn King was formed in 1992, to draft corporate governance guidelines. Four reports have been issued by the King Committee since then –

- (King I), 1994
- (King II), 2002
- (King III), 2009 and
- (King IV) 2016.

The body issued its first report King I Report on Corporate Governance in South Africa, in 1994 which 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. In 2002, the second King Report on Corporate Governance was published. It contained a Code of Corporate Practices and Conduct and referred to seven characteristics of good corporate governance. The King III report was released on 1 September 2009 which 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.

King IV was released on 1 November 2016. It was effective for financial years commencing from 1 April 2017.

King IV builds on King III. It has been revised to bring it up to date with international governance codes and best practice; to align it to shifts in the approach to capitalism (towards inclusive, integrated thinking across the six capitals) and to take account of specific corporate governance developments in relation to effective governing bodies, increased compliance requirements, new governance structures (e.g. Social and Ethics Committee), emerging risks and opportunities from new technologies and new reporting and disclosure requirements e.g. Integrated Reporting.

King IV is 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.

King IV requires an "Apply AND Explain" approach to disclosure, as opposed to King III which was 'Apply Or Explain'. This means that application of the principles is assumed and that an explanation is disclosed on the practices that have been implemented and how these support achieving the associated governance principle.

Whilst King IV is voluntary (unless prescribed by law or a stock exchange Listings Requirement) it is envisaged that it will be applicable to all organisations irrespective of their form or manner of incorporation.

GOVERNANCE ELEMENT	PRINCIPLES
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. 3. The governing body should ensure that the organisation is and is seen to be a responsible corporate citizen.
STRATEGY, PERFORMANCE AND REPORTING	4. The governing body should appreciate that the organisation' score purpose, its risks and opportunities, strategy, business model, performance and sustainable development are all inseparable elements of the value creation process. 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.

GOVERNING STRUCTURES AND DELEGATION	6. The governing body should serve as the focal point and custodian of corporate governance in the organisation. 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. 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. 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. 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.
GOVERNANCE FUNCTIONAL AREAS	11. The governing body should govern risk in a way that supports the organisation in setting and achieving its strategic objectives. 12. The governing body should govern technology and information in a way that supports the organisation setting and achieving its strategic objectives. 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. 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. 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

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 fulfil 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.

ROOTS OF 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, Baharspatya 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.

Kautilya's fourfold duty of a king–	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.
Raksha	**Raksha** – literally means protection, in the corporate scenario it can be equated with the risk management aspect.
Vriddhi	**Vriddhi** – literally means growth, in the present day context can be equated to stakeholder value enhancement
Palana	**Palana** – literally means maintenance/compliance, in the present day context it can be equated to compliance to the law in letter and spirit.
Yogakshema	**Yogakshema** – 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.

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."

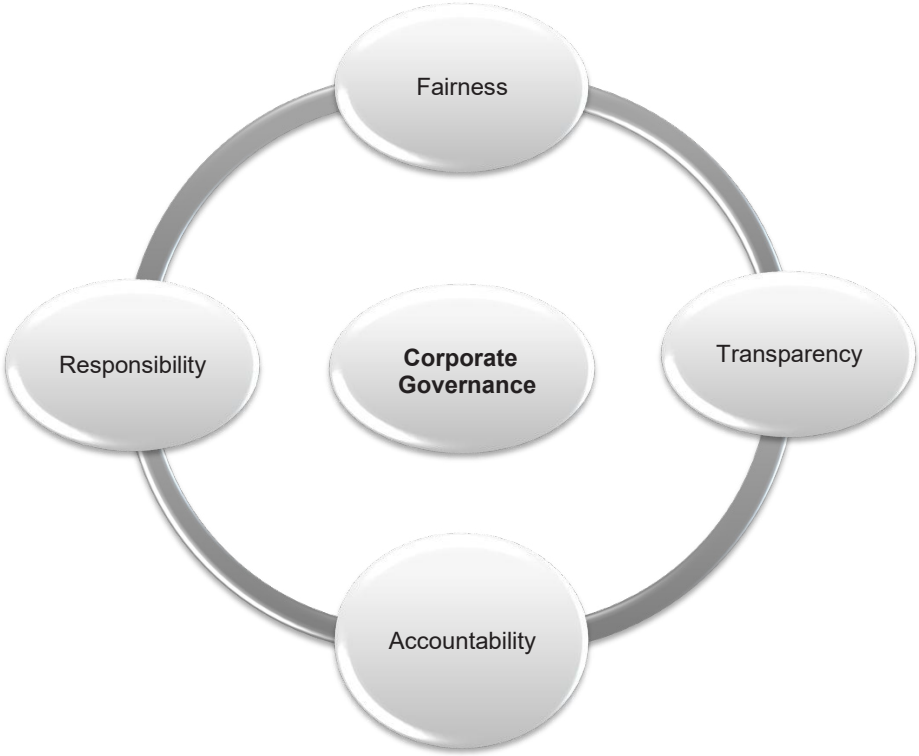
Kautilya has emphasized on the imperatives of the king and his counselors acting in concert. Cohesion is key to the successful functioning of a board and the company it directs. A board that contributes constructively to sustainable success but does not compromise on the integrity and independence of 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.

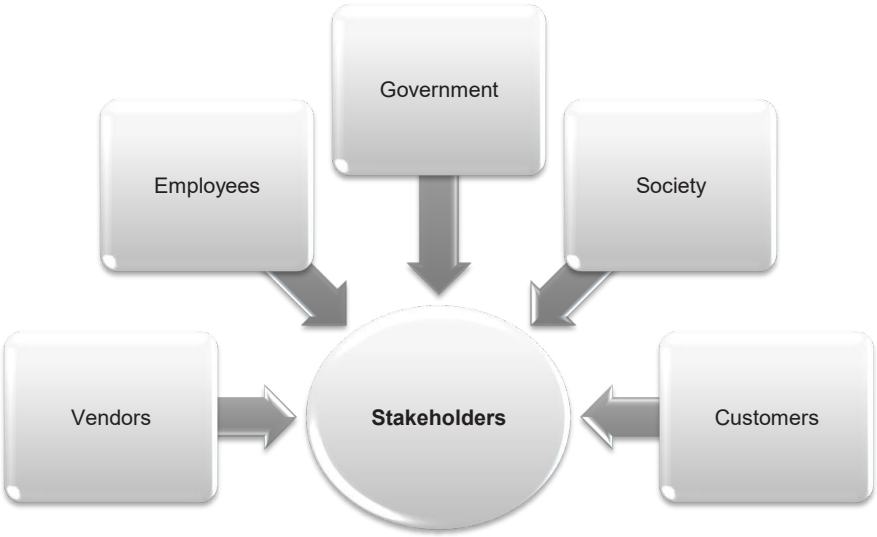
Balancing the interests of the various stakeholders is again at the core of good corporate governance, is highlighted in the Arthashastra and the other ancient texts. There is no prescription in the scriptures that the

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 – CONTEMPORARY 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.

1998 Desirable Corporate Governance: A Code	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.

1999 Kumar Mangalam Birla Committee	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.
2000 Task Force on Corporate Excellence through Governance	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.
2002 Naresh Chandra Committee	The Enron debacle of 2001 involving the hand-in-glove relationship between the auditor and the corporate client, the scams involving the fall of the corporate giants in the U.S. like the WorldCom, Qwest, Global Crossing, Xerox and the consequent enactment of the stringent Sarbanes Oxley Act in the U.S. were some important factors which led the Indian Government to wake up and in the year 2002, Naresh Chandra Committee was appointed to examine and recommend inter alia amendments to the law involving the auditor-client relationships and the role of independent directors.
2003 N. R. Narayana Murthy Committee	In the year 2002, SEBI analyzed the statistics of compliance with the clause 49 by listed companies and felt that there was a need to look beyond the mere systems and procedures if corporate governance was to be made effective in protecting the interest of investors. SEBI therefore constituted a Committee under the Chairmanship of Shri N. R. Narayana Murthy, for reviewing implementation of the corporate governance code by listed companies and for issue of revised clause 49 based on its recommendations.
2004 Dr. J. J. Irani Committee on Company Law	The Government constituted a committee under the Chairmanship of Dr. J. J. Irani, Director, Tata Sons, with the task of advising the Government on the proposed revisions to the Companies Act, 1956 with the objective to have a simplified compact law that would be able to address the changes taking place in the national and international scenario, enable adoption of internationally accepted best practices as well as provide adequate flexibility for timely evolution of new arrangements in response to the requirements of ever- changing business models.

	The Committee recommended that effective measures be initiated for protecting the interests of stakeholders and investors, including small investors, through legal basis for sound corporate governance practices. With a view to protect the interest of various stakeholders, the Committee also recommended the constitution of a "Stakeholders' Relationship Committee" and provision of duties of directors in the Act with civil consequences for non-performance.
2009 CII's Task Force on Corporate Governance	In 2009, CII's Task Force on Corporate Governance gave its report and suggested certain voluntary recommendations for industry to adopt.
2009 Corporate Governance Voluntary Guidelines	Inspired by the industry recommendations, the MCA, in late 2009, released a set of voluntary guidelines on corporate governance. The Guidelines were derived out of the unique challenges of the Indian economy, and took cognizance of the fact that all agencies need to collaborate together, to ensure that businesses flourish, even as they contribute to the wholesome and inclusive development of the country. The Guidelines emphasized that responsible businesses alone will be able to help India meet its ambitious goal of inclusive and sustainable all round development. It urged businesses to embrace the "triple bottom-line" approach whereby their financial performance could be harmonized with the expectations of society, the environment and the many stakeholders in a sustainable manner.
2010 NASSCOM Recommendations	Corporate Governance and Ethics Committee of the National Association of Software and Services Companies (NASSCOM) issued recommendations in mid-2010, focusing on the stakeholders of the company.
2012 Policy Document on Corporate Governance	The Ministry of Corporate Affairs constituted a Committee to formulate a Policy Document on Corporate Governance under the chairmanship of Mr. Adi Godrej with the President ICSI as Member Secretary/ Convenor. The Policy Document sought to synthesize the disparate elements in the diverse guidelines, draw on innovative best practices adopted by specific companies, incorporate current international trends and anticipate emerging demands on corporate governance in enterprises in various classes and scale of operations. The Adi Godrej Committee submitted its report which was articulated in the form of 17 Guiding Principles of Corporate Governance.

2013 Companies Act	The Companies Act, 2013 envisaged radical changes in the sphere of Corporate Governance in India. It provided a major overhaul in Corporate Governance norms and would have far-reaching implications on the manner in which corporate operates in India in coming times. The Companies (Amendment) Act, 2017 consisting of 93 amendments to the 2013 Companies Act, further 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.
2015 SEBI (Listing Obligations and Disclosure Requirements) Regulations	With a view to consolidate and streamline the provisions of existing listing agreements for different segments of the capital market and the provisions pertaining to listed entities with the Companies Act, 2013, the SEBI notified SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 for the listed entities having 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.
2017 Uday Kotak Committee	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. 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

	● 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

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.
- 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

(*These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation*)

1. Discuss in brief the development 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 that led to the evolution of concept of the Corporate Governance?

Lesson 2

Legislative Framework of Corporate Governance in India

LESSON OUTLINE

- Introduction
- Principles for Periodic Disclosures and for Corporate Governance
- Corporate Governance of Banking and Financial Institutions
  - Ganguly Committee recommendations
  - BASEL Committee Corporate Governance Principles
  - Guidelines on Corporate Governance for NBFCs
- Corporate Governance Guidelines for insurance Companies
- Stewardship Code for Insurers in India
- Corporate governance in Public Sector Enterprises
- Guidelines on CSR and Sustainability for Central Public Sector Enterprises
- Glossary
- Lesson Round-up
- Self Test Questions

LEARNING OBJECTIVES

The objective of this study lesson is to understand legislative framework of Corporate Governance for companies, listed companies, the Banks, Insurance Companies and Public Sector Undertakings (PSUs) in our country.

The Companies Act, 2013 is applicable to all companies registered under the Act. SEBI (LODR) Regulations, 2015 are for all listed entities.

Banking and financial institutions has to comply with various circulars issued by RBI, 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 CSR and Sustainability for the Central Public Enterprises provisions as per Companies Act 2013 which are applicable to CPEs have been included in it.

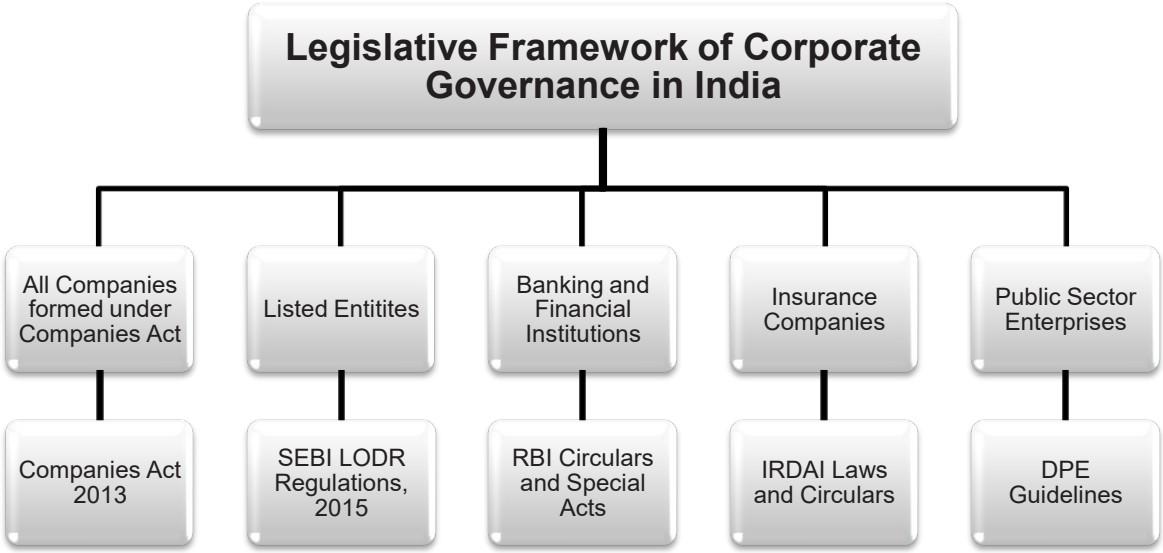
The study aims to enable the students to understand the aforesaid sector specific governance structure.

"A well balanced, inclusive approach, according to certain standard and ideals, is essential for the proper governance of any country"

- Laisenia Qarase

INTRODUCTION

As we have seen in the previous chapter, the initiatives taken by Government of India in 1991, aimed at economic liberalization, privatization and globalisation of the domestic economy, led to various initiatives by the Government of India to improve corporate governance mechanism. Today we have a strong mechanism for governing the activities of companies, all listed entitites, banks, NBFCs and Insurance Companies.



The companies in our country are formed, registered and regulated majorly by the Companies Act, 2013. The erstwhile Companies Act 1956 was completely revamped in 2013 and new Act was framed which is landmark legislation with regard to improving corporate governance of companies. The Companies Act, 2013 clearly indicates focus of regulators toward enhancing the responsibility and accountability of boards. The Act outlines various requirements for Governance, disclosures and enhanced roles, responsibilities and liabilities of the board, its committees and independent directors. Some of the Provisions of Companies Act, 2013 related to Corporate Governance are:

- Appointment and maximum tenure of Independent Directors;
- Appointment of Woman Director;
- Appointment of Whole time Key Managerial Personnel;
- Performance Evaluation of the Directors and Committee & Board as a whole;
- Enhanced disclosures and assertions in Board Report, Annual Return and Directors' Report with regard to Managerial Remuneration, risk management, internal control for financial reporting, legal compliance, Related Party Transactions, Corporate Social Responsibility, shareholding pattern, public money lying unutilised, etc.
- Stricter yet forward-looking procedural requirements for Secretarial compliances and Secretarial Standards made mandatory;
- Enhanced compliances of Related Party Transactions and introduction of concept of arm's length pricing;
- Enhanced restrictions on appointment of Auditors and mandatory rotation of Auditors;
- Separation of role of Chairperson and Chief Executive Officer;
- Mandatory provisions regarding vigil mechanism;

- Constitution of Nomination and Remuneration Committee;
- Constitution of CSR Committee
- Secretarial Audit
- Rotation of Auditors
- Constitution of NFRA

All such provisions of new Company Law are instrumental in providing a good Corporate Governance structure. Further, the Companies (Amendment) Act, 2017 introduces several amendments to the Companies Act 2013, realigning provisions to improve corporate governance and ease of doing business in India while continuing to strengthen compliance and investor protection.

All the listed entities are regulated by the Securities and Exchange Board of India. SEBI is a regulatory authority established on April 12, 1992. SEBI was established with the main purpose of curbing the malpractices and protecting the interest of its investors. Its main objective is to regulate the activities of Stock Exchange and at the same time ensuring the healthy development in the financial market. In order to ensure good corporate governance SEBI had issued detailed Corporate Governance Norms in form of Clause 49 of Listing Agreement which has been now revised and **notified as the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.**

Apart from these, a gamut of legislations like the Competition Act, the Consumer Protection Laws, the labor laws, the environment laws, the anti money laundering laws, Insolvency and Bankruptcy Code etc seeks to ensure good governance practices among the corporate.

NOTE: The Companies Act, 2013 and SEBI (LODR) Regulations, 2015 together deals with virtually all areas affecting Corporate Governance which are discussed at relevant places in the entire study material.

PRINCIPLES FOR PERIODIC DISCLOSURES AND FOR CORPORATE GOVERNANCE

Regulation 4 of the SEBI (LODR) Regulations, 2015 provides for broad principles for periodic disclosures and for corporate governance by listed entities. The principles for periodic disclosures are based on the principles given by International Organization of Securities Commissions (IOSCO). and also have incorporated the principles for corporate governance (in line with OECD principles). These principles underlie specific requirements prescribed in different chapters of the Regulations. In the event of the absence of specific requirements or ambiguity, these principles would serve to guide the 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.

CORPORATE GOVERNANCE OF BANKING AND FINANCIAL INSTITUTIONS

Banking and financial institutions are the strong backbone of any economy. Functioning of banking and financial institutions differs with other corporate entities in many ways which makes good corporate governance of banks very critical and important. RBI had undertaken several measures to strengthen the corporate governance in the Indian banking sector. Various advisory groups and consultative groups were formed to deeply study baking

sector in the light of effective corporate governance.

- In March 2000, an advisory group on corporate governance was formed under the chairmanship of Dr. R. H. Patil.
- Subsequently, another consultative group was formed in November 2001 under the Chairmanship of Dr. A.S. Ganguly, with an objective to strengthen the internal supervisory role of the Boards in banks. The Committee made several recommendations for effective functioning of banks which were circulated by RBI for adoption by all banks.
- On 20th January, 2014, another Committee to Review Governance of Boards of Banks in India was constituted by the RBI Governor under the Chairmanship of P.J Nayak. The Committee had submitted its report with various recommendations in May 2014.

Considering the recommendations of these advisory groups and the global corporate governance experiences, various areas of governance which were potentially important and needed attention, were emphasized. It included defined role of supervisors, ensuring an environment supportive to the sound corporate governance, effective organizational structure to have responsible board of directors, etc. Another global initiative in 1999 of the Basel Committee also brought important principles on corporate governance for banks.

Presently Indian banking sector comprises of Scheduled and Non Scheduled banks, co-operative banks, commercial banks dominated by the government-managed banks including public sector banks, nationalized banks and rural banks, etc. These banks in our country have been established under the different statutes.

- The major law relating to the banking is governed by the Banking Regulation Act 1949.
- The State Bank of India 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).
- The banks listed with the stock exchange have to adhere to the requirement of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Additionally Foreign Exchange Management Act (FEMA), 1999, Payment and Settlement Systems Act, 2007, New Companies Act, 2013 and other directives/ regulations/ guidelines/ instructions issued by RBI and SEBI from time to time have created a positive environment and future scope for enhancing corporate governance. This evolution phase of corporate governance and banking industry experiences created long way of development and setting global standards for corporate governance, which make it more robust and sophisticated in today's time frame.

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.

Recommendations applicable only to public sector bank

(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.

Recommendations applicable only to private sector bank

(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

Basel Committee on Banking Supervision (BCBS) released 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.

GUIDELINES ON CORPORATE GOVERNANCE FOR NBFCS

In order to enable NBFCs to adopt best practices and greater transparency in their operations following guidelines were proposed by RBI vide Circular dated 1dst July, 2013.

These Guidelines are for consideration of the Board of Directors of all Deposit taking NBFCs with deposit size of Rs 20 crore and above and all non-deposit taking NBFCs with asset size of Rs 100 crore and above (NBFC-ND-SI). Listed NBFCs which are required to adhere to listing agreement and rules framed by SEBI on Corporate Governance are also required to comply with SEBI prescriptions on Corporate Governance.

1. **Constitution of Audit Committee** : In terms of extant instructions, an NBFC having assets of Rs. 50 crore and above as per its last audited balance sheet is already required to constitute an Audit Committee, consisting of not less than three members of its Board of Directors, the instructions shall remain valid. In addition, NBFC-D with deposit size of Rs 20 crore may also consider constituting an Audit Committee on similar lines.

2. **Constitution of Nomination Committee**: The importance of appointment of directors with 'fit and proper' credentials is well recognised in the financial sector. In terms of Section 45-IA (4) (c) of the RBI Act, 1934, while considering the application for grant of Certificate of Registration to undertake the business of non-banking financial institution it is necessary to ensure that the general character of the management or the proposed management of the non-banking financial company shall not be prejudicial to the interest of its present and future depositors. In view of the interest evinced by various entities in this segment, it would be desirable that NBFC-D with deposit size of Rs 20 crore and above and NBFC-ND-SI may form a Nomination Committee to ensure 'fit and proper' status of proposed/ existing Directors.

3. **Constitution of Risk Management Committee**: The market risk for NBFCs with Public Deposit of Rs.20 crore and above or having an asset size of Rs.100 crore or above as on the date of last audited balance sheet is addressed by the Asset Liability Management Committee (ALCO) constituted to monitor the asset liability gap and strategize action to mitigate the risk associated. To manage the integrated risk, a risk management committee may be formed, in addition to the ALCO in case of the above category of NBFCs.

4. **Disclosure and transparency**: The following information should be put up by the NBFC 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
   - 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.

5. **Connected Lending:**

   The Bank has received suggestions in the matter with reference to paragraph 2(vi) of the circular dated May 8, 2007 containing instructions on connected lending. The suggestions are being studied and the instructions contained in paragraph 2 (vi) of the said circular will become operational after final evaluation of the suggestions and modifications, if any considered necessary.

   NBFCs shall frame their internal guidelines on corporate governance, enhancing the scope of the guidelines without sacrificing the spirit underlying the above guidelines and it shall be published on the company's web-site, if any, for the information of various stakeholders.

6. **Rotation of partners of the statutory auditors audit firm** - with public deposits/deposits of Rs 50 crore and above: NBFCs with public deposits / deposits of Rs 50 crore and above, stipulate rotation of

partners of audit firms appointed for auditing the company. The partner/s of the Chartered Accountant firm conducting the audit could be rotated every three years so that same partner does not conduct audit of the company continuously for more than a period of three years. However, the partner so rotated will be eligible for conducting the audit of the NBFC after an interval of three years, if the NBFC, so decides. Companies may incorporate appropriate terms in the letter of appointment of the firm of auditors and ensure its compliance.

CORPORATE GOVERNANCE GUIDELINES FOR INSURANCE COMPANIES

The Insurance Regulatory and Development Authority of India (IRDAI) 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) and also the Appointment of statutory auditors of insurers through various circulars.

The IRDAI revised the existing Guidelines in the light of changes brought in by the Companies Act, 2013 vide Circular Dated 18th May 2016 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. These guidelines are applicable to all insurers granted registration by the Authority except:

(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.

The guidelines address the various requirements broadly covering the following major structural elements of Corporate Governance in insurance companies:-

1. Governance Structure

The insurance companies presently could have different structures with the Board of Directors headed by a 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.

(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.

3. 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.

(viii) 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.

4. 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.

5. 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:-
  - 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.

6. 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.

7. 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.

8. 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.

9. Outsourcing Arrangements

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.

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.

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.

10. Interaction with the Regulator

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.

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.

The IRDAI would bring to the attention of the Board and senior management, concerns which have been detected by it through supervisory activities.

Reporting to IRDAI

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.

Each insurer should designate Company Secretary as the Compliance officer whose duty will be to monitor continuing compliance with these guidelines.

Annual Report of insurers shall have a separate certification from the Compliance Officer in the format attached herewith as Annexure 8.

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.

11. Whistle Blower Policy

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.

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.

12. 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 issued the Guidelines on Stewardship Code for Insurers in India in March 2017. The code is in the form of a set of principles, which the insurers would need to adopt. The principles are to be uniformly adopted by 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

Sr. No.	Particluars of Principles of Stewardship Code	Status (Deviation, Partly complied, Not complied)	Reason/Justification for deviation or non-compliance

The principles and the guidance for their implementation are given below:

Stewardship Principles

Principles

S. No.	Principles	Guidance
1.	Insurers should formulate a policy on the discharge of their stewardship responsibilities and publicly disclose it.	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.
2.	Insurers should have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities and publicly disclose it.	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.

3.	Insurers should monitor their investee companies.	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.
4.	Insurers should have a clear policy on intervention in their investee companies.	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.
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.	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.
6.	Insurers should have a clear policy on voting and disclosure of voting activity.	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.

7.	Insurers should report periodically on their stewardship activities.	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.

Annexure B

The format for disclosure of voting by insurance companies in general meetings of listed companies:

Management Proposals

Date	Type of Meeting (AGM / EGM) Proposal	Management Recommendation	Vote (For / Against / Abstain) and rationale therefor

Shareholder Proposals

Date	Type of Meeting (AGM / EGM) Proposal	Management Recommendation	Vote (For / Against / Abstain) and rationale therefor

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 (LODR) Regulations, 2015. 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

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) Disclosures:

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 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 installments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company)

– 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

LESSON ROUND UP

- Legal and regulatory framework of corporate governance in India is mainly covered under the Companies Act, 2013, Listing Regulations, 2015 and SEBI guidelines.
- 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 exchanges. Companies that are listed on the stock exchanges are required to comply with the Listing Regulations, 2015.
- 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.

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 also have to adhere to 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 3

Board Effectiveness

LESSON OUTLINE

- Introduction
- Role of the Board of directors
- Meaning of Board of Directors
- Types of Directors under Companies Act, 2013
- Composition and Structure of Board
- Selection and Appointment of Directors
- Duties of the Directors
- Powers of the Board
- Independent Directors for better board effectiveness
- Other Good Practices to enhance board effectiveness
  - Appointment of Lead Independent Director
  - Separation of role of Chairman and Chief Executive Officer
  - Succession planning
  - Directors training, Development and familarisation
  - Performance Evaluation of the Board and Management
- Board effectiveness and the Role of the Company Secretary
- Guidance on Board Effectiveness (Issued by FRC, UK – July 2018)
- Board Effectiveness Indicators
- MODEL Board Charter
- GLOSSARY
- LESSON ROUND UP
- SELF TEST QUESTIONS

LEARNING OBJECTIVES

The objective of this study lesson is to enable the students to understand who are board of directors, their role, powers and duties etc. The types of directors required to be appointed under the laws, board composition and role of independent director in ensuring board effectiveness.

Various other provisions and guidance which improves board effectiveness like appointment of Lead Independent Director, Separation of role of Chairman and Chief Executive Officer, Succession planning, Directors training, Development and familarisation and Performance Evaluation of the Board and Management has been dealt in detail in this Chapter.

The study also 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 for Evaluation purpose etc.

"Heterogeneous BoDs with independent thinking enforce governance, and diversity strengthens creativity."

– Pearl Zhu

INTRODUCTION

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 contribution of board of directors 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.

An effective board defines the company's purpose and then sets a strategy to deliver it, shapes its culture and the way it conducts its business. It sets the main trends and factors affecting the long-term success and future viability of the company – for example technological change or environmental impacts – and how these and the company's principal risks and uncertainties have been addressed.

The board should have sound understanding of how value is created over time, key strategies and business models towards a sustainable future. This is not limited to value that is found in the financial statements. An understanding of how value for intangible sources are developed, managed and sustained – for example a highly trained workforce, intellectual property or brand recognition – is increasingly relevant to an understanding of the company's performance and the impact of its activity. These are important considerations for boards when setting corporate strategy.

Boards have a responsibility for the health of the company and need to take a long-term view. This is in contrast to the priorities of some investors, not all of whom will be aligned with the pursuit of success over the long-term. An effective board will manage the conflict between short-term interests and the long-term impacts of its decisions; it will assess shareholder and stakeholder interests from the perspective of the long-term sustainable success of the company.

ROLE OF THE BOARD OF DIRECTORS

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. An effective board develops and promotes its collective vision of the company's purpose, its culture, its values and the behaviours it wishes to promote in conducting its business. The role of Board in particular includes:

- providing direction for management;
- demonstrate ethical leadership, displaying – and promoting throughout the company – behaviours consistent with the culture and values it has defined for the organisation;
- create a performance culture that drives value creation without exposing the company to excessive risk of value destruction;
- make well-informed and high-quality decisions based on a clear line of sight into the business;
- create the right framework for helping directors meet their statutory duties under the Companies Act 2013, and/or other relevant statutory and regulatory regimes;
- being accountable, particularly to those that provide the company's capital; and
- think carefully about its governance arrangements and embraces evaluation of their effectiveness.

MEANING OF BOARD OF DIRECTORS

As per Section 2(10) of the Companies Act, 2013 "Board of Directors" or "Board", in relation to a company means the collective body of directors of the company appointed to the Board of the Company

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".

Directors

As per Section 2(34) of the Companies Act, 2013 'director' means a director appointed to the Board of the Company

A 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.

TYPES OF DIRECTORS UNDER COMPANIES ACT 2013

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.

As per Rule 2(1)(k) of the Companies (Specification of definitions details) Rules, 2014 "Executive Director" means a Whole Time Director as defined in clause (94) of section 2 of the Act".

As per Clause 2(94) of Companies Act, 2013 "whole-time director" includes a Director in the whole-time employment of the company.

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

Non executive directors 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.

Non-executive Director is nowhere described under Companies Act, 2013. However, meaning of non- executive Director can be taken from the definition of Executive Director. A person who is not falling in conditions of definition of 'Executive Director' shall be considered as 'Non-Executive Director'. Therefore, one can opine that all the Directors except 'Whole Time Director' and "Managing Director' shall be considered as Non- Executive Director.

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.

The Companies Act, 2013 has taken care of such individuals, who are not a member of Board of Directors, yet maintain complete control over the affairs of the company. Such directors are circumstantially categorised under the Companies Act, 2013, as "Person in accordance with whose instructions the board is accustomed to act" and can also be deemed to be Director of a Company. However, in commercial phraseology, such persons are defined as a "Shadow Director".

A Shadow Director is an "officer" within the definition of the terms in Section 2 (59) of the Companies Act, 2013, as it includes, "any person in accordance with whose directions or instructions the Board of Directors or any one or more of the Directors is or are accustomed to act".

The Companies Act, 2013 deals with such Shadow Directors under various sections. A few of these have been summarized below:

- Section 2(60)(v) wherein, the meaning of "officer who is in default" includes within itself any person in accordance with whose directions or instructions the Board of directors of the company usually acts.
- Section 219(c) which is in the nature of empowering the inspectors to investigate into affairs of any company, which is or whose Board is usually acting in accordance with the instructions or orders of any Director of the company under investigation.

4. Woman Director

A board composed of directors representing a range of perspectives leads to an environment of collaborative discussion which is the essence of good governance. Organizations that aim to deliver the highest standards of leadership require a diversity of thought, skills, experience, working style and talent capability. 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.

The Companies Act, 2013 in India recognized the importance of gender diversity and provides for mandatory appointment of atleast one women director in the listed and other specified class of companies. 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 .

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.

6. Independent Director

Independent Directors play a pivotal role in maintaining a transparent working environment in the corporate regime. Independent Directors constitute such category of Directors who are expected to have impartial and objective judgment for the proper functioning of the company.

Section 2(47) of the Companies Act 2013 provides that “independent director” means an independent director referred to in sub-section (6) of section 149. (Details pertaining to independent directors are discussed later in this chapter).

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 SEBI (LODR) Regulations, 2015 and section 149(6) of the Companies Act, 2013 specifically exclude nominee director from being considered as Independent.

8. Small Shareholders Director

According to Section 151 of the Companies Act, 2013 every listed company may have one director elected by

"small shareholders". For the purpose of this section, "small shareholder" 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 companies act 2013 laid down the terms and conditions for appointment of Small Shareholder's Director. A listed company, may upon notice of not less than 1000 or one-tenth of the total number of small shareholders, whichever is lower, have a Small Shareholders' Director elected by the small shareholders. A listed company may suo moto (on its own accord) opt to have a director representing small shareholders. Thus the Small Shareholder's Director's appointment is optional and made available to listed companies only.

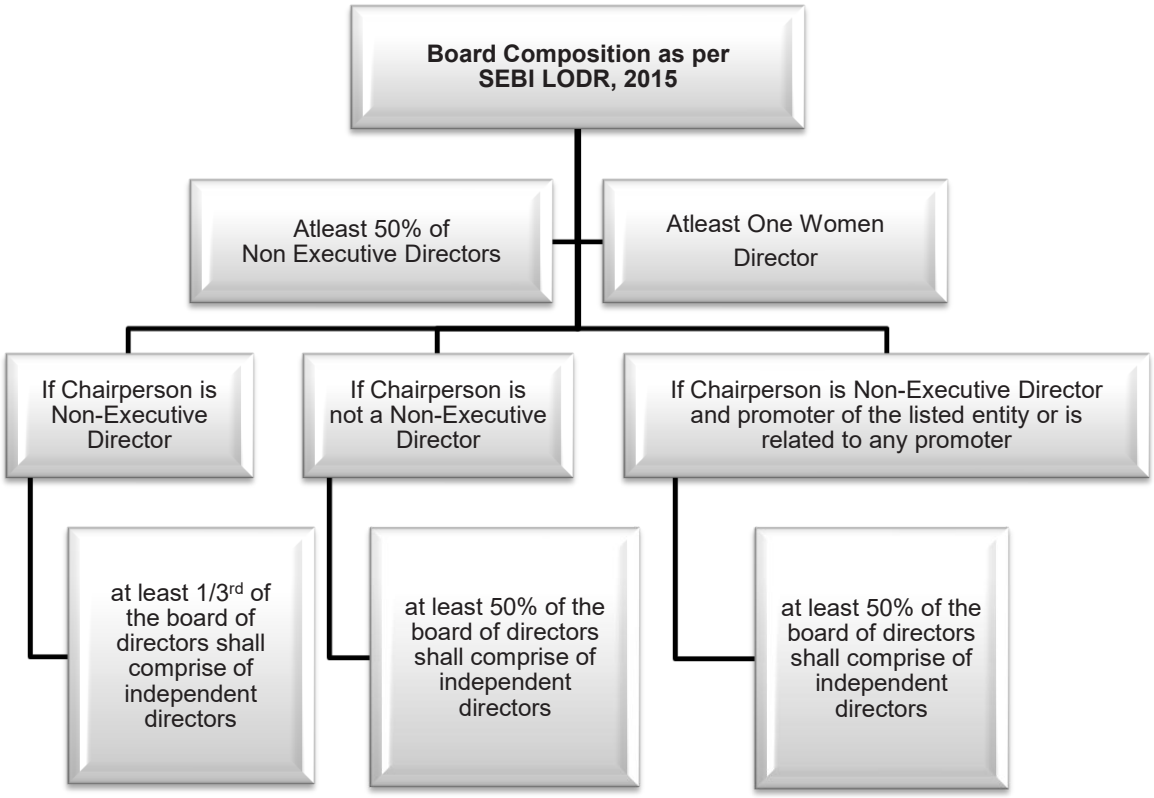
COMPOSITION AND STRUCTURE OF BOARD

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 composition and structure of the Board as prescribed under the law is given hereunder-

Particulars	Companies Act, 2013	SEBI (LODR) Regulations, 2015
Size of the Board	Section 149(1) provides every company shall have a Board of Directors consisting of individuals as directors and shall have – ● A minimum number of three directors in the case of a public company, ● Atleast two directors in the case of a private company, and ● Atleast one director in the case of a One Person Company; and ● A maximum of fifteen directors provided that a company may appoint more than fifteen directors after passing a special resolution. Note: Maximum directors' clause not applicable to Government Company and Section 8 Company.	● Regulation 17(1)(a) provides that Board of directors shall have an optimum combination of executive and non-executive directors with at least one woman director and not less than fifty per cent. of the board of directors shall comprise of non-executive directors; ● 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. ● Regulation 17(1)(c) provides the board of directors of the top 1000 listed entities (with effect from April 1, 2019) and the top 2000 listed entities (with effect from April 1, 2020) shall comprise of not less than six directors. *Explanation* : The top 500, 1000 and 2000 entities shall be determined on the basis of market capitalisation, as at the end of the immediate previous financial year.]

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. Note: Not applicable to Government Company and IFSC Public Company 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. The following classes of unlisted public company shall not be covered under sub-rule (1), namely:-. (a) a joint venture; (b) a wholly owned subsidiary; and (c) a dormant company as defined under section 455 of the Act.”]	*Regulation 17* (1) (b) provides that the composition of board of directors of the listed entity shall be as follows: where the chairperson of the board of directors is a non-executive director, at least one-third of the board of directors shall comprise of independent directors and where the listed entity does not have a regular non-executive chairperson, at least half of the board of directors shall comprise of independent directors: Provided that where 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 half of the board of directors of the listed entity shall consist of independent directors. *Explanation*. – For the purpose of this clause, the expression “related to any promoter” shall have the following meaning: (i) if the promoter is a listed entity, its directors other than the independent directors, its employees or its nominees shall be deemed to be related to it; (ii) if the promoter is an unlisted entity, its directors, its employees or its nominees shall be deemed to be related to it. *Regulation 17* (1A) specifies that no listed entity shall 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.



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 capabilities 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.

Both the Companies Act 2013 and SEBI (LODR) Regulations, 2015 provides for the mandatory constitution of the Nomination and Remuneration Committee (NRC) for selection and appointment of directors.

The 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.

Various provisions regarding the Nomination and Remuneration Committee are discussed in Chapter of Board Committees.

DUTIES OF THE DIRECTORS

A director is "bound to take such precautions and show such diligence in their office as a prudent man of business would exercise in the management of his own affairs."

– Trustees of the Orange River Land & Asbestos Company vs King (1892)

The Duties and Responsibilities can be broadly classified into two categories:

- The duties, liabilities and responsibilities which promotes corporate governance through the sincerest efforts of directors in efficient management and swift resolution of critical corporate issues and sincere and mature decision making to avoid unnecessary risks to the corporate entity and its shareholders.
- Keeping the interests of company and its stakeholders ahead of personal interests.

The following duties of the directors have been provided under Section 166 of the Companies Act, 2013 and apply to all types of directors including Independent Directors.

(1) Subject to the provisions of this Act, a director of a company shall act in accordance with the articles of the company.

(2) 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.

(3) A director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.

(4) A director of a company shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.

(5) A director of a company shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.

(6) A director of a company shall not assign his office and any assignment so made shall be void.

(7) If a director of the company contravenes the provisions of this section such director shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

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 of the Act 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.

INDEPENDENT DIRECTORS FOR BETTER BOARD EFFECTIVENESS

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 on 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) Fulfill 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

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:

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;

(ii) 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;

(iii) 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

(iv) 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' 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.

Role and Functions of Independent Directors

Schedule IV of the Companies Act 2013 specifies the independent directors shall:

(1) help in bringing an independent judgment to bear on the Board's deliberations especially on issues of strategy, performance, risk management, resources, key appointments and standards of conduct;

(2) bring an objective view in the evaluation of the performance of board and management;

(3) scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance;

(4) satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible;

(5) safeguard the interests of all stakeholders, particularly the minority shareholders;

(6) balance the conflicting interest of the stakeholders;

(7) determine appropriate levels of remuneration of executive directors, key managerial personnel and senior management and have a prime role in appointing and where necessary recommend removal of executive directors, key managerial personnel and senior management;

(8) moderate and arbitrate in the interest of the company as a whole, in situations of conflict between management and shareholder's interest.

Duties of Independent Directors

Schedule IV of the Companies Act 2013 provides that the independent directors shall have following duties-

(1) undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company;

(2) seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice and opinion of outside experts at the expense of the company;

(3) strive to attend all meetings of the Board of Directors and of the Board committees of which he is a member;

(4) participate constructively and actively in the committees of the Board in which they are chairpersons or members;

(5) strive to attend the general meetings of the company;

(6) where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, insist that their concerns are recorded in the minutes of the Board meeting;

(7) keep themselves well informed about the company and the external environment in which it operates;

(8) not to unfairly obstruct the functioning of an otherwise proper Board or committee of the Board;

(9) pay sufficient attention and ensure that adequate deliberations are held before approving related party transactions and assure themselves that the same are in the interest of the company;

(10) ascertain and ensure that the company has an adequate and functional vigil mechanism and to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use;

(11) report concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy;

(12) ["act within their authority"], assist in protecting the legitimate interests of the company, shareholders and its employees;

(13) not disclose confidential information, including commercial secrets, technologies, advertising and sales promotion plans, unpublished price sensitive information, unless such disclosure is expressly approved by the Board or required by law.

Separate Meetings of Independent Directors

Schedule IV of the Companies Act 2013 and Regulation 25(3) of SEBI (LODR) regulations, 2015 provides that

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 and all the independent directors of the company shall strive to be present at such meeting to undertake following-

(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.

Liability of Independent Directors

Section 149(12) of the Companies Act 2013 provides that an independent director and a non-executive director not being 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) of SEBI (LODR) regulations, 2015 provides that 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.

Also Regulation 25(10) provides that with effect from October 1, 2018, the top 500 listed entities by market capitalization calculated as on March 31 of the preceding financial year, shall undertake Directors and Officers insurance ('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.

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.

OTHER GOOD PRACTICES TO ENHANCE BOARD EFFECTIVENESS

APPOINTMENT OF LEAD INDEPENDENT DIRECTOR

Internationally, it is considered a good practice to designate an independent director as a lead independent director or senior independent director. The lead independent director is a highly versatile intermediary between the chair, the board and the board's stakeholders. The lead independent director must keep a keen eye on whether the chair is performing their role to the board's satisfaction without losing objectivity or independence. They monitor the relationship between the chair and the CEO, and ensure that it is a well-functioning working relationship without becoming too close or powerful. The lead independent director also 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.

Role of the lead independent director

- 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.

SEPARATION OF ROLE OF CHAIRMAN AND CHIEF EXECUTIVE OFFICER

Chairman: Good boards are created by good chairmen. The chairman creates the conditions for overall board and individual director effectiveness. The chairman should demonstrate the highest standards of integrity and probity, and set clear expectations concerning the company's culture, values and behaviours, and the style and tone of board discussions. The chairman, with the help of the executive directors and the company secretary, sets the agenda for the board's deliberations.

The Companies Act, 2013 does not legally recognize chairman of a company. They are elected by the board 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. Thus, under the law, chairman or chairperson is not legal position but a momentary position in meetings.

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's role includes

- demonstrating ethical leadership;
- setting a board agenda which is primarily focused on strategy, performance, value creation and accountability, and ensuring that issues relevant to these areas are reserved for board decision;
- ensuring a timely flow of high-quality supporting information; regularly considering succession planning and the composition of the board etc.

Chief Executive Officer (CEO): The Board appoints the CEO based on the criterion of his capability and competence to manage the company effectively.

As per Section 2(18) of the Companies Act, 2013, "Chief Executive Officer" means an officer of a company, who has been designated as such by it.

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.

Separation of Role: It is perceived that separating the roles of chairman and chief executive officer (CEO) increases the effectiveness of a company's board. 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 there is less accountability. 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:

- Director Communication: A separate chairman provides a more effective channel for the board to express its views on management

- Guidance: A separate chairman can provide the CEO with guidance and feedback on his/her performance
- Shareholders' interest: The chairman can focus on shareholder interests, while the CEO manages the company
- Governance: A separate chairman allows the board to more effectively fulfill its regulatory requirements
- Long-Term Outlook: Separating the position allows the chairman to focus on the long-term strategy while the CEO focuses on short-term profitability
- Succession Planning: A separate chairman can more effectively concentrate on corporate succession plans.

Provisions under Companies Act, 2013: First proviso to Section 203(1) of the Companies Act, 2013 provides for the separation of role of Chairman and Chief Executive Officer subject to conditions thereunder. It specifies that an individual shall not be appointed or reappointed as the chairperson of the company, in pursuance of the articles of the company, as well as the managing director or Chief Executive Officer of the company at the same time after the date of commencement of this Act unless,—

(a) the articles of such a company provide otherwise;

(b) the company does not carry multiple businesses:

This proviso shall not apply to public companies having paid-up share capital of rupees one hundred crore or more and annual turnover of rupees one thousand crore or more which are engaged in multiple businesses and have appointed Chief Executive Officer for each such businesses. For the purposes of this, the paid-up share capital and the annual turnover shall be decided on the basis of the latest audited balance sheet.

Provisions under SEBI (LODR) Regulations, 2015

Regulation 17(1B) of SEBI (LODR) Regulations, 2015 provides that 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:

Provided that 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.

SUCCESSION PLANNING

Succession planning is a strategy for identifying and developing future leaders. Succession plans are used to address the inevitable changes that occur when directors resign, retire or die. Attention to succession planning can help ensure the board includes directors with a balanced level of institutional knowledge and fresh perspectives.

A well-prepared board should develop a succession plan that provides guidance on identifying and sourcing potential board members who can fulfil key requirements. Succession planning is an ongoing process of identifying, assessing and developing people to ensure the continuity of the Board. It is most important that boards of directors are prepared for resignation and/or retirement of its members. The board should continually ensure that it has the right set of skills, talents, and attributes represented.

Succession planning for the Board includes succession and renewal for the Board as a whole and the Board's leadership positions. The key to getting succession planning right is maintaining an ongoing and dynamic process. The nomination and remuneration committee should review the skills required, identify the gaps, develop transparent appointment criteria and inform succession planning. The nomination and remuneration committee should periodically assess whether the desired outcome has been achieved, and propose changes to the process as necessary.

Executive directors may be recruited from external sources, but companies should also develop internal talent and capability. Initiatives might include middle management development programmes, facilitating engagement from time to time with non-executive directors, and partnering and mentoring schemes.

Some leading practices for board succession planning are:

- Using a skills matrix to proactively shape board composition that incorporates strategic direction and opportunities, regulatory and industry developments, challenges, and transformation
- Conducting robust annual performance evaluations, including facilitation by an independent third party
- Establishing and enhancing written director qualification standards that align with the company's business and corporate strategy, and including these standards in corporate governance policies and bylaws as appropriate
- Reviewing evolving committee and board leadership needs, including the time commitments required
- Considering director election results and engagement by investors regarding board composition, independence, leadership and diversity
- Prioritizing an independent mindset on boards, including through board diversity, to foster debate, challenge norms and invigorate board oversight processes and strategy development
- Making sure mentoring and development opportunities are available for incoming directors.

Legal Provisions on Succession planning	**Companies Act, 2013**	**SEBI (LODR) Regulations, 2015**
	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.

DIRECTORS TRAINING, DEVELOPMENT AND FAMILARISATION

Director's Training: An important aspect of Board effectiveness would be appropriate attention to development and training of directors. Director orientation/induction should be seen as the first step of the board's continuing improvement. 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. Investing in board development strengthens the board and individual directors. 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. Training should focus on improving the knowledge and skills of the board and individual members and on overall board performance. Training should be required for each board member and compliance with the requirement used to assess individual board member performance for reappointment

to additional terms of board service. Requirements should be set forth in a board policy that describes the focus and type of education available.

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.

Director's Development: 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

Familiarisation Programme for Independent Directors: Regulation 25(7) of SEBI (LODR) regulations, 2015 provides that 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.

Schedule IV of the Companies Act 2013 also provides that the Independent Directors shall undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company.

PERFORMANCE EVALUATION OF THE BOARD AND MANAGEMENT

Board evaluation is a key means by which boards can recognize and correct corporate governance problems and add real value to their organizations. A properly conducted board evaluation can contribute significantly to performance improvements on organisational; board and individual member level. Board evaluation typically examines the roles of the Board and the entailing responsibilities, and assesses how effectively these are fulfilled by the Board. The stakeholders and investors are interested to know whether the members of Board are effectively functioning individually and collectively. The Board at many times requires new skills for promptly responding to the dynamic changing business environment. Performance measurement, against the set benchmarks, in the form of Board evaluation has the potential to significantly enhance Board effectiveness, maximize strengths, tackle weaknesses and improve corporate relationships. Annual assessment is a powerful tool to convert good boards into great boards.

Evaluation provides the board and its committees with the opportunity to consider how group culture, cohesiveness, composition, leadership, meetings information processes and governance policies influence performance. Board Evaluation helps to identify areas for potential adjustment and provides an opportunity to remind directors of the importance of group dynamics and effective board and committee processes in fulfilling board and committee responsibilities.

Thus, Board evaluation contributes significantly to improved performance at three levels - organizational, Board and individual Board member level. It also improves the leadership, teamwork, accountability, decision-making, communication and efficiency of the board. A commitment to annual evaluation is powerful change agent.

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

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

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

- Overall growth of the organisation.

Requirements under the Companies Act 2013

1. The Role of the Nominations and Remuneration Committee in performance evaluation of directors

Section 178 (2): 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].

2. Independent Directors' role in performance evaluation of Boards, non-independent directors and Chairperson

Schedule IV [Part II (2)] : Independent directors are required to bring an objective view in the evaluation of the performance of board and management.

Schedule IV (Part VII) : The independent directors are required to hold at least one meeting in a year, without the attendance of non-independent directors and members of the management and in that meeting they are required to review the performance of

- the non-independent directors and
- the Board as whole; and
- also review the performance of the Chairperson of the company, taking into account the views of the executive and non-executive directors.

3. Performance evaluation of Independent Directors

Schedule IV Part V: Re appointment - The reappointment of the independent directors would be based on their report of performance evaluation.

Schedule IV Part VIII : Evaluation mechanism

The performance of the independent directors would have to be done by the entire Board excluding the director to be evaluated.

On the basis of the report of performance evaluation, the continuance or extension of the term of appointment of the independent director would be determined.

Thus, the Board of every listed company and every other public company having paid- up share capital of twenty five crores or more calculated at the end of the preceding financial year except Government Companies has to do formal annual evaluation of the-

- board
- its committees and
- all individual directors.

The Board's report of such companies must include a statement indicating the manner & criteria of formal Board Evaluation.

Provisions under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

It also requires Boards to conduct an annual performance evaluation and its disclosure in the annual report through the following provisions:

1. Regulation 17(10) mandates that entire board of directors shall do the performance evaluation of independent directors, provided that in the evaluation process, the directors who are subject to evaluation shall not participate.
2. Regulation 19(4) read with Part D of Schedule II - It provides that the role of committee shall, inter-alia, include the following:
   - formulation of criteria for evaluation of performance of independent directors and the board of directors;
   - 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.

Frequency of Board Evaluation

Section 134(3)(p) provides that there has to be a formal annual evaluation of Board of its own performance and that of its committees and individual directors. The Company may undertake annual evaluation either in accordance with calendar year or financial year, as there is no clarity on this. Ideally, the same should be as per financial year.

Broad Evaluation framework and parameters

Boards should understand the framework under which board and committee evaluations are conducted, and take steps to ensure evaluations are carried out effectively. As per the Companies Act 2013 or SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Board evaluation would generally include following:

1. Evaluation of the Board as a whole
2. Evaluation of the Committees
3. Evaluation of Individual Directors
   - Managing Director / Whole time Director / Executive Director
   - Independent Directors
   - Non- executive Directors
4. Evaluation of the Chairperson

1. Evaluation of the Board as a whole:

The performance of the Board as a whole may be evaluated either from the reviews/ feedback of the directors themselves or by some external source. The Independent Directors at their separate meeting shall also 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.The evaluation of the performance of the Boards is essentially an assessment of how the Board has performed on following parameters which determines the effectiveness of boards.

- **Board Structure** : its composition, constitution and diversity and that of its Committees, competencies of the members, Board and Committee charters, frequency of meetings, procedures;
- **Dynamics and Functioning of the Board** : annual Board calendar, information availability, interactions

and communication with CEO and senior executives, Board agenda, cohesiveness and the quality of participation in Board meetings;

- **Business Strategy Governance**: Board's role in company strategy;
- **Financial Reporting Process, Internal Audit and Internal Controls**: The integrity and the robustness of the financial and other controls regarding abusive related party transactions, vigil mechanism and risk management;
- **Monitoring Role**: Monitoring of policies, strategy implementation and systems;
- **Supporting and Advisory Role**; and
- **The Chairperson's Role**.

2. EVALUATION OF THE COMMITTEES

The Board is responsible for the evaluation of the performance of the Committees of the Board. The performance of the committees may be evaluated by the Directors, on the basis of the terms of reference of the committee being evaluated. The evaluation may be externally facilitated. The broad parameters of reviewing the performance of the Committees, inter alia, are:

- Discharge of its functions and duties as per its terms of reference;
- Process and procedures followed for discharging its functions;
- Effectiveness of suggestions and recommendations received;
- Size, structure and expertise of the Committee; and
- Conduct of its meetings and procedures followed in this regard.

3. EVALUATION OF INDIVIDUAL DIRECTOR(s)

(a) Evaluation of Managing Director / Whole time Director / Executive Director

The performance evaluation of Managing Director, Executive Director of the Company may be done by all the directors. The external facilitation may also serve as the efficient tool for evaluation. As per the Code for Independent Directors also provides that Independent Directors should review the performance of non-independent Directors, which include Managing Director / Whole time Director/ Executive Director. The broad parameters for reviewing the performance of Managing Director/ Executive Director are:

- Achievement of financial/business targets prescribed by the Board;
- Developing and managing / executing business plans, operational plans, risk management, and financial affairs of the organization;
- Display of leadership qualities i.e. correctly anticipating business trends, opportunities, and priorities affecting the Company's prosperity and operations;
- Development of policies, and strategic plans aligned with the vision and mission of Company and which harmoniously balance the needs of shareholders, clients, employees, and other stakeholders;
- Establishment of an effective organization structure to ensure that there is management focus on key functions necessary for the organization to align with its mission; and
- Managing relationships with the Board, management team, regulators, bankers, industry representatives and other stakeholders.

(b) Evaluation of Independent Directors:

The performance evaluation of independent directors should 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.

The Nomination Committee shall lay down the evaluation criteria for performance evaluation of independent directors. The company should disclose the criteria for performance evaluation, as laid down by the Nomination Committee, in its Annual Report.

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
- The effectiveness of the directions provided by the Board on the issues discussed in meetings.

Parameters: In addition to the parameters laid down for Directors, which shall be common for evaluation to both Independent and Non- executive directors, an Independent director shall also be evaluated on the following parameters:

- Exercise of objective independent judgment in the best interest of Company;
- Ability to contribute to and monitor corporate governance practice; and
- Adherence to the code of conduct for independent directors.
- Performance of the Board against the benchmark performance 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.

(c) Evaluation of Non-Executive Directors

In terms of the Code for Independent Directors, the Independent director(s) on the Board of the Company should evaluate the performance of Non-independent director(s) which include non-executive director(s). Peer Review method or external evaluation may also facilitate the purpose of evaluating Non-executive directors. The broad parameters for reviewing the performance of Non-executive Directors are:

- Participation at the Board / Committee meetings;
- Commitment (including guidance provided to senior management outside of Board/ Committee meetings);
- Effective deployment of knowledge and expertise;
- Effective management of relationship with stakeholders;
- Integrity and maintaining of confidentiality;
- Independence of behaviour and judgment; and
- Impact and influence.

4. EVALUATION OF CHAIRPERSON OF THE BOARD

The performance of the Chairperson is linked to both the functioning of the Board as a whole as well as the performance of each director. The Code for Independent Directors provides that the Independent Director should review the performance of the Chairperson of the company taking into account the views of the executive directors and non-executive directors.

Therefore, all the directors of the Board of the company thereof contribute in evaluating the performance of the Chairperson of the Board. External agencies may also be involved in evaluating the Chairperson.

The broad parameters for reviewing the performance of Chairperson of the Board are:

- Managing relationship with the members of the Board and management;
- Demonstration of leadership qualities;
- Relationship and communication within the Board;
- Providing ease of raising of issues and concerns by the Board members; and
- Promoting constructive debate and effective decision making at the board;
- Relationship and effectiveness of communication with the shareholders and other stakeholders;
- Promoting shareholder confidence in the Board and
- Personal attributes i.e. Integrity, Honesty, Knowledge,etc.

BOARD EFFECTIVENESS AND THE ROLE OF THE COMPANY SECRETARY

A Company Secretary acts as a vital link between the company and its Board of Directors, shareholders and other stakeholders and regulatory authorities. A Company Secretary is a close confidante of the board and commands 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.

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.

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.

The Companies Act, 2013 Act confers a special status to Company Secretary as the key managerial personnel

and has bracketed him along with Managing Director (MD) or Chief Executive Officer (CEO) or Manager, Whole-time director(s) or Chief Financial Officer (CFO).

According to Section 203(1) of the Act, it is mandatory for every listed company and every other public company having a paid up share capital of ten crore rupees or more to appoint a whole time Key Managerial Personnel (KMP). Also a company other than a company covered above which has a paid up share capital of five crore rupees or more shall have a whole-time company secretary.

The company secretaries have also been empowered as secretarial auditor under section 204 of the Companies Act, 2013. The Company Secretaries are recognised as advisors to the Board on the affairs of the Company and all matters to ensure good Corporate Governance by the Companies Act itself. They are also required to guide the Board on its own role, responsibilities and duties.

Regulation 6(1) of SEBI (LODR) Regulations, 2015 also provides that every listed entity shall appoint a qualified company secretary as the compliance officer.

In order to enhance effectiveness of board functioning, the company secretary should report to the chairman on all board governance matters. The company secretary should ensure the presentation of high-quality information to the board and its committees. The company secretary can also add value by fulfilling, or procuring the fulfilment of, other requirements of the Code on behalf of the chairman, in particular director induction and development. This should be in a manner that is appropriate to the particular director, and which has the objective of enhancing that director's effectiveness in the board or board committees, consistent with the results of the board's evaluation processes. The chairman and the company secretary should periodically review whether the board and the company's other governance processes, for example board and committee evaluation, are fit for purpose, and consider any improvements or initiatives that could strengthen the governance of the company. The company secretary's effectiveness can be enhanced by his or her ability to build relationships of mutual trust with the chairman, the senior independent director and the non-executive directors, while maintaining the confidence of executive director colleagues.

GUIDANCE ON BOARD EFFECTIVENESS

(Issued by FRC, UK – July 2018)

The primary purpose of the Guidance on Board Effectiveness (the Guidance) is to stimulate boards' thinking on how they can carry out their role and encourage them to focus on continually improving their effectiveness. The Guidance on Board Effectiveness is includes commentary on areas such as culture, relations with the workforce and wider shareholders and diversity. It also incorporates new sections on the workings of board committees, notably the remuneration committee. Helpfully, the Guidance includes questions for boards to ask themselves or, in some cases, to ask management, about effectiveness in key areas.

The Guidance is not mandatory and is not prescriptive. It contains suggestions of good practice to support directors and their advisors in applying the Code.

The Guidance also includes some of the procedural aspects of governance and is intended to act as a reminder to boards and their support teams that good practice and procedure should continue to be followed. The tools and techniques for board effectiveness are suggested in the Guidance to assist companies in applying the Principles of good corporate governance.

BOARD EFFECTIVENESS INDICATORS

Sample questions which can be used as a quick check for board effectiveness in any organization.

Are the majority of your board members independent from the organization?

- Do you have a set of required competencies articulated for your board (and committees), and do your current board members as a whole display the entire set of required competencies?
- Do you have a board manual that articulates terms of reference for the board, board committees, individual directors, and the code of conduct? Does it have a forward list of topics for the year?
- Does at least one member of the board have extensive experience in the industry of your organization?
- Does each director get a comprehensive orientation on the business of the organization and meet key senior staff before the first board meeting?
- Are directors offered continuing education in governance or a program of director certification?
- Does each director display a keen interest or passion in the undertaking of the organization?
- Do directors regularly attend both board and committee meetings?
- Are directors encouraged and supported when asking difficult or awkward questions of management?
- Does the Chairman solicit views from each director specifically?
- Does the Chairman ask board members to refrain from expressing their personal views at the outset of a discussion?
- Does the Chair manage the timing of the board meetings to ensure there is sufficient time for discussion after each topic addressed by management?
- Does the board regularly have outside experts attend to present on specific topics?
- Does the board have an in-camera meeting both before and after each board meeting?
- Does the board retain an independent consultant to help evaluate director and board performance?
- At the beginning of a board meeting, do the committee chairs have an opportunity to summarize (verbally or in writing) the issues addressed and decisions taken at prior committee meetings?
- Does the board have an effective system to provide board members with timely, relevant and reliable financial and strategic information about the organization?
- Does the board review the risk identification and management system of the organization?
- Does the board approve the business plan and major expenditures?
- Does the board work with the CEO and senior staff to develop and review the strategic plan?

MODEL 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 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
- Board Evaluation
- Directors liability insurance
- Director Induction
- Non-Executive Director Remuneration
- Reimbursement of expenses

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.

– 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.
- 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.

SELF TEST QUESTIONS

(*These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation*)

1. Should the role of Chairman and CEO be separated?
2. 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.
3. Write Short Notes on –
   (a) Board Composition
   (b) Training of Directors
   (c) Board Charter
   (d) Lead Independent Director
   (e) Board Evaluation

Lesson 4

Board Processes through Secretarial Standards

LESSON OUTLINE

- Introduction
- SS-1: Meetings of the Board of Directors
- Board processes through Secretarial Standards
  - Convening a Meeting
  - Frequency of Meetings
  - Quorum
  - Attendance at Meetings
  - Chairman
  - Passing of Resolution by Circulation
  - Minutes
  - Preservation of Minutes and other Records
  - Disclosures
- Meeting through Video Conferencing
- Glossary
- LESSON ROUND-UP
- SELF TEST QUESTIONS

LEARNING OBJECTIVES

Corporate governance is about owners and the managers operating as the trustees on behalf of every shareholder–large or small. In exchange for the right to run the company for the long term, boards have an obligation to ensure the proper management of the affairs of the Company. 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.

The fundamental principles with respect to Board Meetings are laid down in the Companies Act, 2013 and the Secretarial Standard -1 facilitates compliance with these principles by endeavoring to provide further clarity where there is ambiguity and establishing benchmark standards to harmonise prevalent diverse practices.

The objective of this study lesson is to enable the students to understand, Board Processes like Convening a Meeting, Frequency of Meetings, Quorum, Attendance at Meetings, Passing of Resolution by Circulation, Minutes, Preservation of Minutes and other Records and Disclosures through Secretarial Standard-1.

"A decisive Board is cogitative, proactive, and supportive."

– Pearl Zhu

INTRODUCTION

There have been significant developments with regard to conduct of board meetings in the Companies Act 2013. The use of electronic mode for sending notice of meetings, passing of resolution by circulation and other areas have been allowed. The Act has permitted directors to participate in board meetings through video conferencing or other audio visual means. Certain new actions like issuance of securities, grant of loans, guarantee or security, approval of financial statement and board's report, diversification of business have been identified for approval by directors in a board meeting. Requirement for holding board meeting every quarter has been discontinued.

One significant development with regard to conduct of board meetings is observance of secretarial standards. Secretarial Standards are a codified set of good governance practices which seek to integrate, harmonize and standardise 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. According to Section 118 (10) of the Companies Act 2013, 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.

> Section 118 (10) of Companies Act 2013- 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 (56 of 1980), and approved as such by the Central Government.
>
> *(In case of Specified IFSC Public Company and Private Company- Sub-section (10) of section 118 Shall not apply.* - Notification Date 4th January, 2017*)*

In order to ensure high corporate governance standards, the Ministry of Corporate Affairs (MCA) has accorded its approval to the following Secretarial Standards ("SS") specified by the Institute of Company Secretaries of India namely –

(i) SS-1: Meetings of the Board of Directors and

(ii) SS-2: General Meetings

The Secretarial Standards were notified by the Institute of Company Secretaries of India in the Official Gazette and were effective from July 1, 2015. In 2017, the ICSI has issued the Revised Secretarial Standards which has been approved by the Central Government under Section 118(10) of the Companies Act, 2013 and were effective from October 1st, 2017.

Prior to the promulgation of the Companies Act, 2013, the secretarial standards were recommendatory in nature. With the historical moment of launching the Secretarial Standards by the MCA has marked a new era of healthy secretarial practices among corporates.

SS-1: Meetings of the Board of Directors

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. 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.

Companies follow diverse secretarial practices which have evolved over a period of time through varied usages and as a response to differing business cultures. With a view to integrate, harmonise and standardise such practices, the ICSI has formulated Secretarial Standards. The objective of such standards is to make certain uniform corporate practice, procedures and dealings relating to conduct of board meetings. Further, the Secretarial Standards has also clarified certain provisions of the Act, where the law was either silent or ambiguous. However, these standards do not overstep or modify the law in any way.

SS-1 requires Company Secretary 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.

This Standard is applicable to the Meetings of Board of Directors of all companies incorporated under the Act except One Person Company.

The Secretarial Standard 1 seeks to ensure that a healthy and transparent procedure is followed for convening a board meeting. It contains the detailed practices and procedures with regard to conduct of board meetings in companies.

Board processes through Secretarial Standards

1. Convening a Meeting

Authority	➢ Any Director of a company may, at any time, summon a Meeting of the Board, and the Company Secretary or where there is no Company Secretary, any person authorised by the Board in this behalf, on the requisition of a Director, shall convene a Meeting of the Board, in consultation with the Chairman or in his absence, the Managing Director or in his absence, the Whole-time Director, where there is any, unless otherwise provided in the Articles. ➢ The Chairman may, unless dissented to or objected by the majority of Directors present at a Meeting at which a Quorum is present, adjourn the Meeting for any reason, at any stage of the Meeting.
Day, Time, Place, Mode and Serial Number of Meeting	➢ Every Meeting shall have a serial number. ➢ A Meeting may be convened at any time and place, on any day. ➢ Any Director may participate through Electronic Mode in a Meeting unless the Act or any other law specifically prohibits such participation through Electronic Mode in respect of any item of business.

Notice	➢ Notice in writing of every Meeting shall be given to every Director by hand or by speed post or by registered post or by facsimile or by e-mail or by any other electronic means. ➢ Notice shall be issued by the Company Secretary or where there is no Company Secretary, any Director or any other person authorised by the Board for the purpose. ➢ The Notice shall specify the serial number, day, date, time and full address of the venue of the Meeting. ➢ The Notice shall inform the Directors about the option available to them to participate through Electronic Mode and provide them all the necessary information. ➢ The Notice of a Meeting shall be given even if Meetings are held on pre-determined dates or at pre-determined intervals. ➢ Notice convening a Meeting shall be given at least seven days before the date of the Meeting, unless the Articles prescribe a longer period.
Agenda and Notes on Agenda	➢ The Agenda, setting out the business to be transacted at the Meeting, and Notes on Agenda shall be given to the Directors at least seven days before the date of the Meeting, unless the Articles prescribe a longer period. ➢ Each item of business requiring approval at the Meeting shall be supported by a note setting out the details of the proposal, relevant material facts that enable the Directors to understand the meaning, scope and implications of the proposal and the nature of concern or interest, if any, of any Director in the proposal, which the Director had earlier disclosed. ➢ Each item of business to be taken up at the Meeting shall be serially numbered. ➢ Any item not included in the Agenda may be taken up for consideration with the permission of the Chairman and with the consent of a majority of the Directors present in the Meeting ➢ To transact urgent business, the Notice, Agenda and Notes on Agenda may be given at shorter period of time than stated above, if at least one Independent Director, if any, shall be present at such Meeting.

2. Frequency of Meetings

Meetings of the Board	The company shall hold at least four Meetings of its Board in each Calendar Year with a maximum interval of one hundred and twenty days between any two consecutive Meetings.
Meetings of Committees	Committees shall meet as often as necessary subject to the minimum number and frequency prescribed by any law or any authority or as stipulated by the Board.

Meeting of Independent Directors	Where a company is required to appoint Independent Directors under the Act, such Independent Directors shall meet at least once in a Calendar Year.

3. Quorum

General Provisions	➢ Quorum shall be present throughout the Meeting. ➢ Quorum shall be present not only at the time of commencement of the Meeting but also while transacting business. ➢ A Director shall neither be reckoned for Quorum nor shall be entitled to participate in respect of an item of business in which he is interested. However, in case of a private company, a Director shall be entitled to participate in respect of such item after disclosure of his interest. ➢ Directors participating through Electronic Mode in a Meeting shall be counted for the purpose of Quorum, unless they are to be excluded for any items of business under the provisions of the Act or any other law.
Meetings of the Board	➢ The Quorum for a Meeting of the Board shall be one-third of the total strength of the Board, or two Directors, whichever is higher. ➢ Where the number of Directors is reduced below the minimum fixed by the Articles, no business shall be transacted unless the number is first made up by the remaining Director(s) or through a General Meeting.
Meetings of Committees	Unless otherwise stipulated in the Act or the Articles or under any other law, the Quorum for Meetings of any Committee constituted by the Board shall be as specified by the Board. If no such Quorum is specified, the presence of all the members of any such Committee is necessary to form the Quorum.

4. Attendance at Meetings

- Every company shall maintain attendance register for the Meetings of the Board and Meetings of the Committee.
- The attendance register shall contain the following particulars: serial number and date of the Meeting; in case of a Committee Meeting name of the Committee; place of the Meeting; time of the Meeting; names and signatures of the Directors, the Company Secretary and also of persons attending the Meeting by invitation and their mode of presence, if participating through Electronic Mode
- The attendance register shall be deemed to have been signed by the Directors participating through Electronic Mode, if their attendance is recorded in the attendance register and authenticated by the Company Secretary or where there is no Company Secretary, by the Chairman or by any other Director present at the Meeting, if so authorised by the Chairman and the fact of such participation is also recorded in the Minutes.
- The attendance register shall be maintained at the Registered Office of the company or such other place as may be approved by the Board.
- The attendance register is open for inspection by the Directors. Even after a person ceases to be a Director, he shall be entitled to inspect the attendance register of the Meetings held during the period of his Directorship.
- The attendance register shall be preserved for a period of at least eight financial years from the date of last entry made therein and may be destroyed thereafter with the approval of the Board.

- The attendance register shall be in the custody of the Company Secretary.
- Leave of absence shall be granted to a Director only when a request for such leave has been communicated to the Company Secretary or to the Chairman or to any other person authorised by the Board to issue Notice of the Meeting.

5. Chairman

Meetings of the Board	➢ The Chairman of the company shall be the Chairman of the Board. If the company does not have a Chairman, the Directors may elect one of themselves to be the Chairman of the Board. ➢ The Chairman of the Board shall conduct the Meetings of the Board. If no such Chairman is elected or if the Chairman is unable to attend the Meeting, the Directors present at the Meeting shall elect one of themselves to chair and conduct the Meeting, unless otherwise provided in the Articles.
Meetings of Committees	➢ A member of the Committee appointed by the Board or elected by the Committee as Chairman of the Committee, in accordance with the Act or any other law or the Articles, shall conduct the Meetings of the Committee. If no Chairman has been so elected or if the elected Chairman is unable to attend the Meeting, the Committee shall elect one of its members present to chair and conduct the Meeting of the Committee, unless otherwise provided in the Articles.

6. Passing of Resolution by Circulation

Authority	➢ The Chairman of the Board or in his absence, the Managing Director or in their absence, any Director other than an Interested Director, shall decide, before the draft Resolution is circulated to all the Directors, whether the approval of the Board for a particular business shall be obtained by means of a Resolution by circulation. ➢ Where not less than one-third of the total number of Directors for the time being require the Resolution under circulation to be decided at a Meeting, the Chairman shall put the Resolution for consideration at a Meeting of the Board.
Procedure	➢ A Resolution proposed to be passed by circulation shall be sent in draft, together with the necessary papers, to all the Directors including Interested Directors on the same day. ➢ The draft of the Resolution to be passed and the necessary papers shall be circulated amongst the Directors by hand, or by speed post or by registered post or by courier, or by e-mail or by any other recognised electronic means. ➢ Each business proposed to be passed by way of Resolution by circulation shall be explained by a note setting out the details of the proposal, relevant material facts that enable the Directors to understand the meaning, scope and implications of the proposal, the nature of concern or interest, if any, of any Director in the proposal, which the Director had earlier disclosed and the draft of the Resolution proposed. The note shall also indicate how a Director shall signify assent or dissent to the Resolution proposed and the date by which the Director shall respond.

Approval	➢ The Resolution is passed when it is approved by a majority of the Directors entitled to vote on the Resolution, unless not less than one-third of the total number of Directors for the time being require the Resolution under circulation to be decided at a Meeting.
Recording	➢ Resolutions passed by circulation shall be noted at a subsequent Meeting of the Board and the text thereof with dissent or abstention, if any, shall be recorded in the Minutes of such Meeting.
Validity	➢ Passing of Resolution by circulation shall be considered valid as if it had been passed at a duly convened Meeting of the Board.

7. Minutes

Maintenance of Minutes	➢ 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. ➢ 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.
General Contents of Minutes	➢ Minutes shall state, at the beginning the serial number and type of the Meeting, name of the company, day, date, venue and time of commencement of the Meeting. ➢ Minutes shall record the names of the Directors present physically or through Electronic Mode, the Company Secretary who is in attendance at the Meeting and Invitees, if any, including Invitees for specific items. ➢ Minutes shall contain a record of all appointments made at the Meeting.

Specific Contents of Minutes	➢ Minutes shall inter-alia contain: (a) The name(s) of Directors present and their mode of attendance, if through Electronic Mode. (b) In case of a Director participating through Electronic Mode, his particulars, the location from where he participated and wherever required, his consent to sign the statutory registers placed at the Meeting. (c) The name of Company Secretary who is in attendance and Invitees, if any, for specific items and mode of their attendance if through Electronic Mode. (d) Record of election, if any, of the Chairman of the Meeting. (e) Record of presence of Quorum. (f) The names of Directors who sought and were granted leave of absence. (g) Noting of the Minutes of the preceding Meeting. (h) Noting the Minutes of the Meetings of the Committees. (i) The text of the Resolution(s) passed by circulation since the last Meeting, including dissent or abstention, if any. (j) The fact that an Interested Director did not participate in the discussions and did not vote on item of business in which he was interested and in case of a related party transaction such director was not present in the meeting during discussions and voting on such item. (k) The views of the Directors particularly the Independent Director, if specifically insisted upon by such Directors, provided these, in the opinion of the Chairman, are not defamatory of any person, not irrelevant or immaterial to the proceedings or not detrimental to the interests of the company. (l) If any Director has participated only for a part of the Meeting, the Agenda items in which he did not participate. (m) The fact of the dissent and the name of the Director who dissented from the Resolution or abstained from voting thereon. (n) Ratification by Independent Director or majority of Directors, as the case may be, in case of Meetings held at a shorter Notice. (o) Consideration of any item other than those included in the Agenda with the consent of majority of the Directors present at the Meeting and ratification of the decision taken in respect of such item by a majority of Directors of the company. (p) The time of commencement and conclusion of the Meeting

Recording of Minutes	➢ 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.
Finalisation of Minutes	➢ 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.
Entry in the Minutes Book	➢ 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.
Signing and Dating of Minutes	➢ 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.

Inspection and Extracts of 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.

8. Preservation of Minutes and other Records

- 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.

9. Disclosures:

The Report of the Board of Directors shall include a statement on compliances of applicable Secretarial Standards.

Illustrative list of items of business for the Agenda for the First Meeting of the Board of the company

1. To appoint the Chairman of the Meeting.
2. To note the Certificate of Incorporation of the company, issued by the Registrar of Companies.
3. To take note of the Memorandum and Articles of Association of the company, as registered.
4. To note the situation of the Registered Office of the company and ratify the registered document of the title of the premises of the registered office in the name of the company or a Notarised copy of lease / rent agreement in the name of the company.
5. To note the first Directors of the company.
6. To read and record the Notices of disclosure of interest given by the Directors.
7. To consider appointment of Additional Directors.
8. To consider appointment of the Chairman of the Board.
9. To consider appointment of the first Auditors.
10. To adopt the Common Seal of the company, if any.
11. To appoint Bankers and to open bank accounts of the company.
12. To authorise printing of share certificates and correspondence with the depositories, if any.
13. To authorise the issue of share certificates to the subscribers to the Memorandum and Articles of Association of the company.
14. To approve and ratify preliminary expenses and preliminary agreements.
15. To approve the appointment of the Key Managerial Personnel, if applicable and other senior officers

Some Good Practices in Convening Board Meetings

Maintaining 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.

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. 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.

MEETING THROUGH VIDEO CONFERENCING

Section 173(2) of Companies Act, 2013 read with Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014, provides that the participation of directors in a meeting of the Board may be either in person or through video conferencing or other audio visual means as may be prescribed, which are capable of recording and recognizing the participation of the directors and of recording and storing the proceedings of such meetings along with date and time.

The Complete process for conducting of Board Meeting through video conferencing is prescribed under Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014 read with Secretarial Standard – 1.

The notice of the meeting shall inform the Directors regarding the option available to them to participate through video conferencing mode. The notice shall also contain all the necessary information to enable the directors to participate through video conferencing mode. Like: contact no. or e-mail address of the Chairman or any other person authorized by the Board, to whom the Director shall confirm in this regard. The notice shall also seek advance confirmation from the Directors as to whether they will participate through Electronic Mode in the Meeting. Director who intends to participate through video conferencing shall give prior intimation to Chairman of the Company (In the absence of intimation it shall be assumed that Director will attend in person).

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 has received the Agenda and all the relevant material for the meeting (Like: Draft Resolutions, Notes to Agenda etc) and

d. That no one other than the concerned director is attending or having access to the proceedings of the meeting at the location mentioned in clause (b);

After the roll call, the Chairperson shall confirm that the required quorum is complete. A director participating in a meeting through video conferencing or other audio visual means shall be counted for the purpose of quorum. If a statement of a director in the meeting through video conferencing or other audio visual means is interrupted or garbled, the Chairperson shall request for a repeat or reiteration by the Director.

The minutes of the meeting shall disclose the particulars of the directors who attended the meeting through

video conferencing or other audio visual means and the location from where and the Agenda items in which he participated.

The following types of matters cannot be discussed in a board meeting conducted through video conference:

1. Approval of the annual financial statements.
2. Approval of the Board's report.
3. Approval of the prospectus.
4. Audit Committee Meetings for consideration of accounts.
5. Approval of the matter relating to amalgamation, merger, demerger, acquisition and takeover.

GLOSSARY

- **Agenda**: An agenda is a list of meeting activities in the order in which they are to be taken up, beginning with the call to order and ending with adjournment. It usually includes one or more specific items of business to be acted upon. It may, but is not required to, include specific times for one or more activities. An agenda may also be called a docket, schedule, or calendar. It may also contain a listing of an order of business.
- **Minutes**: Minutes, also known as minutes of meeting, protocols or informally notes are the instant written record of a meeting or hearing.
- **Quorum**: It is the smallest number of people needed to be present at a meeting before it can officially begin and before official decisions can be taken.
- **Timestamp** means the current time of an event that is recorded by a Secured Computer System and is used to describe the time that is printed to a file or other location to help keep track of when data is added, removed, sent or received.
- **Secretarial Auditor** means a Company Secretary in Practice appointed in pursuance of the Act to conduct the secretarial audit of the company.

LESSON ROUND-UP

- According to Section 118 (10) of the Companies Act 2013, 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.
- The Ministry of Corporate Affairs (MCA) has accorded its approval to the Secretarial Standards ("SS") specified by the Institute of Company Secretaries of India.
- The Secretarial Standards were notified by the Institute of Company Secretaries of India in the Official Gazette and were effective from July 1, 2015.
- 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.
- SS-1 requires Company Secretary to oversee the vital process of recording and facilitating implementation of the decisions of the Board.
- SS-1 is applicable to the Meetings of Board of Directors of all companies incorporated under the Act except One Person Company.
- SS-1 provides for some of the best standard practices to be followed for conduct of meetings by the companies.

SELF TEST QUESTIONS

(*These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation*)

1. Write a short note on frequency of meetings as per Secretarial Standard 1.
2. Companies follow diverse secretarial practices. In the light of this statement explain the importance of Secretarial Standards.
3. What are the Secretarial Standards specified in respect of Notice and Notes on Agenda?
4. Write short notes on -
   a) General Content of Minutes
   b) Specific Content of minutes

Lesson 5

Board Committees

LESSON OUTLINE

- Introduction
- Need for Committees
- Rationale behind Board Committees
- Committee Management
- Selection of Committee Members
- Appointment of Committee Chairman
- Mandatory Committees of the Board
- Audit Committee
- Nomination and Remuneration Committee
- Stakeholders Relationship Committee
- CSR Committee
- Risk Management Committee
- Other Committees
- 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"

– 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 mearsures, 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

With the increasing business complexities and time commitment of Board members, constituting committees has become inevitable for organization of any significant size.

The Companies Act, 2013 and SEBI (LODR) Regulations, 2015 have provided a very robust regulatory framework to emphasize that effectiveness of Board Committees as key to an effective Board.

Committees keep the number of participants manageable; in larger groups, either many people do not get to speak or discussion gets quite lengthy. Committees can be set up for a specific purpose or to deal with general issues such as 'development'. They can be established on a short-term or temporary basis, or they can be formed as a permanent body for ongoing work.

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. 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.

COMMITTEE MANAGEMENT

- Committees function in accordance with the terms of reference established by the board.
- Committees may be standing committees; or ad-hoc committees that cease when the activities are completed. Standing committees should be included in the articles or bylaws.
- Committees recommend policy for approval by the entire board.
- Committees make full use of board members' expertise, time and commitment, and ensure diversity of opinions on the board.
- They do not supplant responsibility of each board member; they operate at the board level and not the staff level.
- Minutes should be recorded for all Committee meetings and final minutes are required to be placed before the Board.

Table F of Schedule I of the Companies Act, 2013 provides that articles of association of a company limited by shares shall contain the following:

71. (i) The Board may, subject to the provisions of the Act, delegate any of its powers to committees consisting of such member or members of its body as it thinks fit.

(ii) Any committee so formed shall, in the exercise of the powers so delegated, conform to any regulations that may be imposed on it by the Board.

72. (i) A committee may elect a Chairperson of its meetings.

(ii) If no such Chairperson is elected, or if at any meeting the Chairperson is not present within five minutes after the time appointed for holding the meeting, the members present may choose one of their members to be Chairperson of the meeting.

73. (i) A committee may meet and adjourn as it thinks fit.

(ii) Questions arising at any meeting of a committee shall be determined by a majority of votes of the members present, and in case of an equality of votes, the Chairperson shall have a second or casting vote.

74. All acts done in any meeting of the Board or of a committee thereof or by any person acting as a director, shall, notwithstanding that it may be afterwards discovered that there was some defect in the appointment of any one or more of such directors or of any person acting as aforesaid, or that they or any of them were disqualified, be as valid as if every such director or such person had been duly appointed and was qualified to be a director.

75. Save as otherwise expressly provided in the Act, a resolution in writing, signed by all the members of the Board or of a committee thereof, for the time being entitled to receive notice of a meeting of the Board or committee, shall be valid and effective as if it had been passed at a meeting of the Board or committee, duly convened and held.

SELECTION OF COMMITTEE MEMBERS

Specific committee members may be appointed by either the Board or the committee Chairman. Area of knowledge and expertise domain and time commitment of the Board member should be considered as the criteria for the selection on any specific committee. The committee members should be selected with following questions in mind: What tasks are the committee responsible for and who among the members possess the skills and experience needed to complete those tasks. Every effort should be made to match the needs and requirements of the committee and the skills, knowledge and interests of prospective committee members.

It is very important that members have a clear view of the committee's goals and the chairman should have flair to utilize the committee member's knowledge exponentially well to achieve those goals.

APPOINTMENT OF THE COMMITTEE CHAIRMAN

The Board may appoint the committee chairman or the committee members can choose/elect the chairman. The committee chairman is the key to an effective committee, he sets the tone, pace and strategies of the committees' functioning, hence chairman selected should have motivational and leadership skills and time commitment expected of him.

In seeking an effective chairman, most important things are knowledge and experience relevant to the work of the committee, proven leadership and behavioral skills that will be essential if the committee is to work effectively. The role of committee chairman requires extra work, time for communication with committee members and senior management so that he remains informed about the developments and a willingness to resolve conflicts among members.

The committee chairman co-ordinates work and establishes an environment of thoughtful deliberation. The chairman is expected to stimulate the members and help the group use all the abilities and experiences its members possess and new skills that they develop as they work together. The committee's goal must be aligned to achieve the objectives of the organization as a whole. The committee chairman will be responsible for preparing agendas for the meetings, assigning responsibilities to committee members and doing some of the follow-up to make sure that the assigned work is being done by members.

According to "Articles of Association" under Table F of Schedule I of the Companies Act, 2013, committee may elect a Chairperson of its meetings. Where no such Chairperson is elected, or if at any meeting the Chairperson is not present within five minutes after the time appointed for holding the meeting, the members present may choose one of their members to be Chairperson of the meeting.

The Secretarial Standards (SS-1) provides that a member of the Committee appointed by the Board or elected by the Committee as Chairman of the Committee, in accordance with the Act or any other law or the Articles, shall conduct the Meetings of the Committee. If no Chairman has been so elected or if the elected Chairman is unable to attend the Meeting, the Committee shall elect one of its members present to chair and conduct the Meeting of the Committee, unless otherwise provided in the Articles.

Suggested Content of the Terms of References of Committees

1. Objectives
2. Composition
3. Secretary
4. Quorum
5. Meetings
6. Annual General Meeting
7. Authority
8. General Responsibilities
9. Specific Responsibilities
10. Reporting
11. Evaluation
12. Review of Committee

MANDATORY COMMITTEES OF THE BOARD

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 under Companies Act 2013

Section 177(1) of the Companies Act, 2013 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 –

(i) All public listed 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.

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 for the purposes of this rule.

Note: 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.

Under SEBI Listing Regulations, 2015

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 conditions specified.

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.

Composition of the Audit Committee

Section 177(2) of the Companies Act, 2013	**Regulation 18(1) of the SEBI (Listing Obligations and Disclosure Requirement) Regulations, 2015**
Audit Committee shall consist of a minimum of three directors. Provided that majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand, the financial statement.	Audit Committee shall have minimum three directors as members.
Independent directors should form a majority. (Not applicable for Section 8 companies vide notification no. GSR 466(E), dated 5-6-2015)	Two-thirds (2/3rd) of the members shall be independent directors.
Majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand the financial statement.	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.

	The chairperson of the audit committee shall be an independent director and he shall be present at AGM to answer shareholder queries.
	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.
	However, occasionally the audit committee may meet without the presence of any executives of the listed entity.

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;

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 statement 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

Section 177 (5), (6) and (7) of the Companies Act, 2013	**Regulation 18(2)(c) of the SEBI Listing Regulations, 2015**
● 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)] ● 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)] ● 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)]	● 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.

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

Under the Companies Act 2013: 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.

Note : Section 178 shall not apply to Section 8 companies are exempted vide Notification no. GSR 466(E), dated 05-06-2015.

Under SEBI (LODR) Regulations, 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

Section 178 of the Act	Regulation 19 of SEBI (LODR) Regulations, 2015
(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: Provided 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.	(1) The board of directors shall constitute the nomination and remuneration committee as follows: a. the Committee shall comprise of at least 3 directors. b. all directors of the committee shall be non-executive directors; and c. at least 50% of the directors shall be independent directors. (2) The Chairperson of the nomination and remuneration committee shall be an independent director.

	Provided that the chairperson of the listed entity, 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 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. [Section 178(4)]

Disclosure in Board's Report and website

Proviso to Section 178(4) also provides that the policy relating to the remuneration of the directors, KMP and

other employees 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)

(1)	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;
(2)	formulation of criteria for evaluation of performance of independent directors and the board of directors;
(3)	devising a policy on diversity of board of directors;
(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 of directors their appointment and removal.
(5)	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.
(6)	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]

STAKEHOLDERS RELATIONSHIP COMMITTEE

Constitution / Compostion of the Stakeholders Committee

Section 178(5) of the Companies Act 2013	Regulation – 20 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
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.	**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]*

	(3) The Chairperson of the Stakeholders Relationship Committee shall be present at the annual general meetings to answer queries of the security holders. [*Substituted by the SEBI LODR Amendment Regulations, 2018 wef 1/4/2019*] (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*]

Functions of the Committee

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 D of Schedule II of SEBI (LODR) Regulations, 2015 provide that 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

Under Companies Act 2013

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
- 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.

RISK MANAGEMENT COMMITTEE

Under SEBI (LODR) Regulations, 2015

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.

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:

(a) 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.

(b) 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.

(c) 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.

(d) 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.

(e) Fraud Monitoring Commitee

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 monitioring committee, which may take care of the checks and balances and preventive measures in order to discourage the employees in their modus operandi.

(f) 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.

(g) 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 Rs. 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

(*These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation*)

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 Policies and Disclosures

LESSON OUTLINE

- Corporate Policies - Meaning and Importance
- Policies under the Companies Act, 2013
- Policies under the SEBI (LODR), Regulations, 2015
- Policies under other laws and voluntary policies
- Introduction to Disclosures and Transparency Requirements
- Mandatory Disclosures
  - In Terms of Companies Act, 2013
  - In Terms of various Rules made Under Companies Act, 2013
  - Under SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009
  - Under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
  - Under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
  - Under SEBI (Prohibition of Insider Trading) Regulations, 2015
- Glossary
- LESSON ROUND-UP
- SELF TEST QUESTIONS

LEARNING OBJECTIVES

Business incorporates a legal system and, for most legal systems, it is a requirement in most countries to formulate and disclose its policies and statements. Many countries have developed laws and procedures and have established guidelines on how and when the accounting disclosures have to be made. Companies release this information in their compiled form of annual reports. These disclosures are also made into other publications other than annual reports. It is compulsory by law and regulators to disclose accounting policies to the shareholder and stockholders of the business. Such disclosures are important for potential investors to decide on investment in the business or corporation.

These disclosures ensure active and transparent communication that is complete, fair, accurate, timely, comprehensible, affordable and equally accessible by all stakeholders, including the shareholders, investors, employees and customers, in compliance with the governing regulations.

In this lesson, the students would learn about various policies that are formulated by the companies under different laws. Also the disclosures to be made by companies including the ones that are listed on recognized stock exchanges. The Chapter provides exhaustive coverage on disclosures which are mandatory under the laws in India.

"The financial crisis is a stark reminder that transparency and disclosure are essential in today's marketplace."

– Jack Reed

CORPORATE POLICIES – MEANING AND IMPORTANCE

Corporate Policy is a formal declaration of the guiding principles by which an organization will function. It is usually developed by its board of directors or a senior management policy committee. 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.

In present scenario, **corporate policies are essential** even for businesses seeking to do things in a different way. Without proper policies, it is extremely tough for the business to continue and policies work as guide and help the manager to direct all the actions towards the same goal.

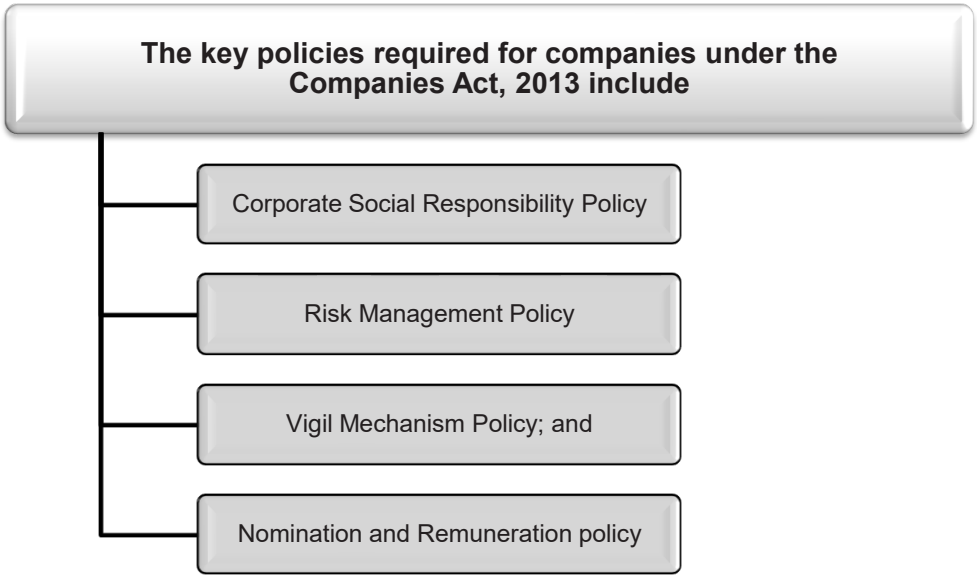
Some points highlighting the importance of corporate policies are given below-

- Policies are necessary to perform the business activities in a smooth way.
- Corporate polices offer clear cut courses for achievement of organizational goals.
- If an appropriate explicit policy has been developed, most of the details can be easily taken care of by the employees and management would not needlessly spend its time as well as energy in performing such tasks.
- Corporate Policies present you with instructions and a platform for making decisions.
- Policies promote delegation of the power of making decisions.
- Properly formulated corporate policies give a direction in which all management pursuits are targeted.
- Policies provide steadiness to the action of the members of the organization.
- Policies and guidelines prevent the subordinates to rethink on the day to day challenges and therefore prevent repeated analysis of problems.
- Policies help in analysis of performance by serving as a standard.
- Corporate policies boost employees' commitment and loyalty for the business.
- It helps in dealing with the issues for optimal utilization of limited resources.
- Sound policies aid in developing good public image of an organization.
- Corporate Polices give the organization clear targets so that the managers can decide regarding the future plan of action.
- They act as tool for co-ordination and control.

Thus we can say that corporate policies are significant for a corporation. They help in the all round development and growth of the organization. A sound corporate policy gives satisfaction to the workers with regards to working conditions, organizational culture, authority, and responsibility.

Policies under the Companies Act 2013

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.



1) Corporate Social Responsibility Policy

Section 135(4) of the Companies Act 2013, the Board of every company required to constitue CSR Committee shall 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, and ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.

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 specifying modalities of execution of such project or programs and implementation schedules for the same
- Monitoring process of such projects or programs
- A clause specifying that the surplus arising out of the CSR projects or programs or activities shall not form part of the business profit of the company.

Activities which may be included by companies in their Corporate Social Responsibility Policies are activities relating to: –

- 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.
- promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly and the differently abled and livelihood enhancement projects.
- 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.
- 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.

- 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 art and handicrafts;
- measures for the benefit of armed forces veterans, war widows and their dependents;
- training to promote rural sports, nationally recognised sports, paralympic sports and olympic sports
- contribution to the prime minister's national relief fund or any other fund set up by the central govt. for socio economic development and relief and welfare of the schedule caste, tribes, other backward classes, minorities and women;
- contributions or funds provided to technology incubators located within academic institutions which are approved by the central govt.
- rural development projects
- slum area development.

2) Risk Management Policy

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 should be included in the report by its Board of Directors.

3) Vigil Mechanism Policy

Section 177 (10) of the Companies Act 2013 provides that 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 and the details of establishment of such mechanism shall be disclosed by the company on its website, if any, and in the Board's report.]

4) Nomination and Remuneration policy

Section 178 (3) and (4) of the Companies Act 2013 provides that the Nomination and Remuneration Committee shall 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 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:

The 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.

Policies under the SEBI (LODR), Regulations, 2015

1. **Risk policy**: The listed entity shall have a risk policy which shall be reviewed and guided by the board of directors. [Regulation 4(2)(f)(ii)(1)]
2. **Policy for preservation of documents**: The listed entity shall have a policy for preservation of documents, approved by its board of directors, classifying them in at least two categories as follows-
   (a) documents whose preservation shall be permanent in nature ;
   (b) documents with preservation period of not less than eight years after completion of the relevant transactions. The documents may be preserved in electronic mode. [Regulation 9]
3. **Archival Policy :** The listed entities would identify all the documents which need to be preserved under various regulations relating to securities laws and then develop a suitable archival policy. According to Section 2 (zf) of Lising Regulations "securities laws" covers the following-
   - The Listing regulations
   - The Securities Contracts (Regulation) Act, 1956,
   - The Depositories Act, 1996,

   The provisions of the Companies Act, 1956 and Companies Act, 2013, and the rules, regulations, circulars or guidelines made thereunder.
4. **Policy for Determining 'Material' Subsidiary**: "Material subsidiary" shall mean a subsidiary, whose income or net worth exceeds 20% of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year. The listed entity shall formulate a policy for determining 'material' subsidiary. [Regulation 16(2)(c)]

5. **Policy on Materiality of 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. The listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions. [Regulation 23(1)]

6. **Policy for determination of materiality of events**: The listed entity shall frame a policy for determination of materiality, duly approved by its board of directors, which shall be disclosed on its website. The policy shall be based on the following criteria for determination of materiality of events/ information:

   - The omission of an event or information, which is likely to result in discontinuity or alteration of event or information already available publicly; or
   - 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;
   - 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.

7. **Whistle Blower Policy**: The listed entity shall formulate a vigil mechanism for directors and employees to report genuine concerns under which they can have direct access to the chairperson of the audit committee in appropriate or exceptional cases and formulate and disclose whistle blower policy. [Regulation 22 and 46 (2) (e)]

8. **Policy relating to the remuneration of the directors, key managerial personnel and other employees**: The listed entity shall formulate a policy on the remuneration of the directors, key managerial personnel and other employees. [Part- D, Schedule II (1)]

9. **Policy on board diversity**: The listed entity shall formulate a policy on diversity of board of directors is mentioned as a role of nomination and remuneration committee. [Part- D, Schedule II (3)]

10. **Dividend Distribution Policy**: Regulation 43A provides that-

    - The top five hundred listed entities based on market capitalization (calculated as on March 31 of every financial year) shall formulate a dividend distribution policy which shall be disclosed in their annual reports and on their websites.
    - The dividend distribution policy shall include the following parameters:
      (a) the circumstances under which the shareholders of the listed entities may or may not expect dividend;
      (b) the financial parameters that shall be considered while declaring dividend;
      (c) internal and external factors that shall be considered for declaration of dividend;
      (d) policy as to how the retained earnings shall be utilized; and
      (e) parameters that shall be adopted with regard to various classes of shares:
    - If the listed entity proposes to declare dividend on the basis of parameters in addition to clauses (a) to (e) or proposes to change such additional parameters or the dividend distribution policy contained in any of the parameters, it shall disclose such changes along with the rationale for the same in its annual report and on its website.
    - The listed entities other than top five hundred listed entities based on market capitalization may

disclose their dividend distribution policies on a voluntary basis in their annual reports and on their websites.

POLICIES UNDER OTHER LAWS AND VOLUNTARY POLICIES

1) **Insider Trading Policy**: A listed company has to also formulate Insider Trading Policy as per the requirements of SEBI (Prohibition of Insider Trading) Regulations, 2015.

2) **Policy for prevention of sexual harassment at workplace**: All companies are required to formulate policy for prevention of sexual harassment at workplace under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013. The policy should contain the procedures and guidelines to govern cases against sexual harassment in the company.

3) **Voluntary Policies**: In addition to above, the companies may also formulate following policies:

   - Code of business conduct & Ethics
   - Ethics policy
   - Information security policy
   - Health and safety policy
   - Gender diversity policy
   - Environmental policy
   - Policy on investor relations
   - Quality policy
   - Social accountability policy
   - Communication policy
   - Investment and cash policy
   - Policy for ascertaining the 'Fit and Proper' status of directors
   - Affirmative action policy
   - Code of corporate disclosures

DISCLOSURE AND TRANSPARENCY REQUIREMENTS

Good corporate governance should ensure that timely and accurate disclosure is made regarding all material matters concerning the corporation, including its financial situation and results. It is in the interest of each organisation to provide clear, timely and reliable information that is adequately prepared, and to make relevant information equally accessible to all stakeholders.

Shareholders and potential investors require access to regular, reliable and comparable information in sufficient detail for them to assess the stewardship of management and make informed decisions about their share value. Insufficient or unclear information can negatively affect the organisation in many ways.

The appropriate dissemination of information should provide for:

- Timely and cost-efficient access to relevant information
- Disclosure of all material developments that arise between regular reports
- Simultaneous reporting of information to all shareholders in order to ensure their equitable treatment
- Non-disclose of information that may endanger the organisation's competitive position

Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure. The various disclosures and transparency requirements under major laws and regulations in our country are given hereunder.

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.

Section134(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 the year;

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

Filing of offer document (Regulation 6)

No issuer shall make,

- a public issue; or
- 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.

4. Under 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)

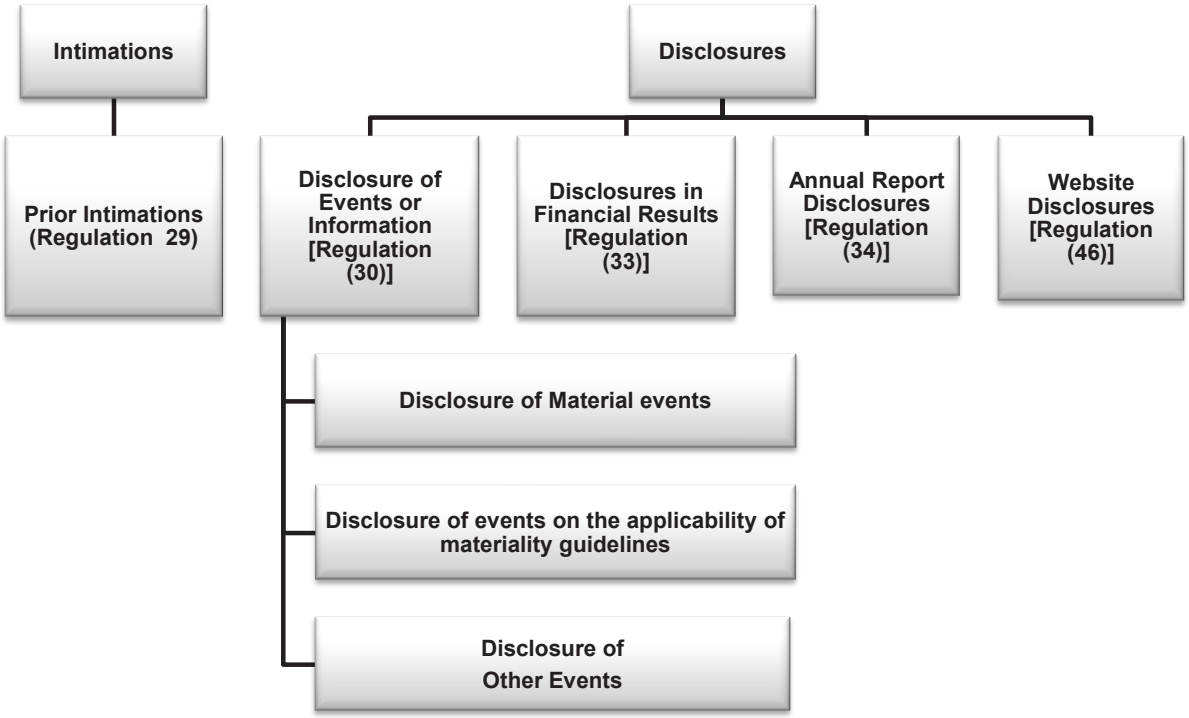
1. The promoter of every target company shall disclose details of shares in such target company encumbered by him or by persons acting in concert with him in the prescribed format.
2. The promoter of every target company shall disclose details of any invocation of such encumbrance or release of such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

5. Under 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.

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)

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.

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:

Sr. No.	In the accounts of	Disclosures of amounts at the year end and the maximum amount of loans/ advances/ Investments outstanding during the year.
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.

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 non-executive 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;
- 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;
- 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 madeby 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;

6. 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]:

Principles of Fair Disclosure for purposes of Code of Practices and Procedures for Fair Disclosure of Unpublished Price Sensitive Information

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.

GLOSSARY

– **Transparency** : In a business or governance context, is honesty and openness. Transparency and accountability are generally considered the two main pillars of good corporate governance.

– **Policy** : A set of ideas or a plan of what to do in particular situations that has been agreed to officially by a group of people, a business organization, a government, or a political party.

– **CSR** : Corporate social responsibility (CSR) is a self-regulating business model that helps a company be socially accountable – to itself, its stakeholders, and the public.

LESSON ROUND UP

– Policies are an essential component of every organization and address important issues.

– The companies should provide easy access to policies and also publicly disclose.

– Corporate policies serve as important forms of internal control, it minimize cost and help in building a learning culture.

– Good corporate governance should ensure that timely and accurate disclosure is made regarding all material matters concerning the corporation, including its financial situation and results.

– The following are the major legislations/regulations/guidelines on transparency and disclosure requirements

  - 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

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1) What are the mandatory policies to be formulated under Companies Act 2013? Describe in brief.
2) What are the disclosure pertaining to financial requirements under SEBI LODR Regulations, 2015?
3) Draft a sample corporate governance report of a listed company.
4) Write short note on CSR Policy.
5) Write in brief about various policies under SEBI LODR Regulations, 2015.

Lesson 7

Accounting and Audit related issues, RPTs and Vigil Mechanism

LESSON OUTLINE

- Introduction
- Strengthening Financial Reporting Standards
- Improving Auditors effectiveness
- Rotation of Auditors
- Compliance with Auditing Standards
- Internal Audit
- Secretarial Audit
- Constitution of NFRA
- Related Party Transactions
- Vigil Mechanism/Whistle Blower
- Glossary
- LESSON ROUND UP
- SELF TEST QUESTIONS

LEARNING OBJECTIVES

Corporate governance pertains to the system of rules businesses use to direct their decisions and justify their actions. It acts as the foundation through which corporations determine and go after their goals within the social, legal and market environment. Because the core function of accounting tasks is to track the company's financial performance, these tasks play an important role in determining how a company fulfils its corporate governance policies. Accounting and auditing practices are highly effective as an instrument of corporate governance.

Keeping this in view, this study lesson covers various good governance initiatives taken by the government of our country for accounting and audit related issues.

It also covers in brief various legal provisions as well as background to related party transactions, meaning of related parties, transactions covered under RPT and the procedure for approval etc.

At the end, lesson provides brief about vigil mechanism, background of whistle blower concept and various laws pertaining to it.

I have gone to great lengths, and in some cases beyond what is required by the reporting guidelines to ensure all of my filings are beyond reproach, by hiring an independent third-party accounting firm to review and audit all of my previous annual financial disclosures.

– Bob Corker

INTRODUCTION

Many of the recent corporate failures like Maxwell in UK, Enron in US and Satyam in India could be attributed to a lack of integrity on the part of management where individuals were involved in aggressive accounting, earnings management or fraudulent financial reporting to manipulate share prices, borrowings and bonus plans. 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. There is a clear need to restore confidence in capital markets and elsewhere by enhancing corporate governance in order to provide financial information of the highest quality. Confidence in financial reporting, and in audit, is a key factor in ensuring confidence in capital markets.

The Cadbury Committee long back had recommended increasing auditors' effectiveness, setting up an audit committee to provide financial oversight and strengthen financial reporting standards for improved disclosures. The Companies Act 2013 and SEBI LODR Regulations provide various provisions for the strengthening of financial standards, auditing standards, mandatory internal audit and secretarial audit for certain class of companies, rotation of auditors constitution of NFRA etc.

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.

In tune with the global trend of adopting International Financial Reporting Standards (IFRS) as reporting language, India has facilitated the convergence of the Accounting Standards of India with IFRS. All the existing Indian Accounting Standards were revised and converged with corresponding International Accounting Standards/International Financial Reporting Standards. These converged Accounting Standards are called "Indian Accounting Standards (Ind AS)".

The Companies 2013 Act, in several sections, has given cognisance to the Indian Accounting Standards, which are standards converged with International Financial Reporting Standards. 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.

The Central Government, in consultation with the National Advisory Committee on Accounting Standards (NACAS), had notified the Companies (Indian Accounting Standards) Rules, 2015 in exercise of the powers conferred by section 133 and section 469 of the Companies Act, 2013 and sub-section (1) of section 210A of the Companies Act, 1956. These rules will came into force on 1st April 2015. There are now two separate sets of Accounting Standards in India –

1) **Indian accounting Standards (Ind AS) as specified in the Annexure to Companies (Indian Accounting Standards) Rules, 2015**

   Indian Accounting Standards (Ind AS) are the accounting standards prescribed under Section 133 of the Companies Act, 2013 which are specified in the Annexure to Companies (Indian Accounting Standards) Rules, 2015. These accounting standards are converged with corresponding International Financial Reporting Standards.

2) **Accounting standards as specified in Annexure to the Companies (Accounting Standards) Rules, 2006**

   The Central Government in consultation with NACAS, has notified Companies (Accounting Standards) Rules, 2006 in exercise of the powers conferred by clause (a) of sub-section (1) of section 642 and sub-section (3C) of section 211 and sub-section (1) of section 210A of the Companies Act, 1956. Under

these rules, 28 Accounting Standards as recommended by the Institute of Chartered Accountants of India are prescribed. These Accounting Standards are as per the Generally Accepted Accounting Principles of India and not converged with International Financial Reporting Standards.

Regulation 48 of SEBI (LODR) Regulations, 2015 also provides that the listed entity shall comply with all the applicable and notified Accounting Standards from time to time.

Disclosure requirements pertaining to Accounting Standards

Section 129(5) of the Companies Act 2013 provides-	**Regulation34(3) read with Schedule V of SEBI LODR Regulations, 2015 provides-**
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.	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.

IMPROVING 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. 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
   (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 indebtness 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).

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.

Oversight of Auditors: 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.

Reporting of Fraud by Auditors : Section 143 (12) of the Companies Act 2013 read with Companies (Audit and Auditors) rules, 2015 provides that If an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of rupees one crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.

In case of a fraud involving lesser than the amount specified in sub-rule (1), the auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than two days of his knowledge of the fraud and he shall report the matter specifying the following:-

- Nature of Fraud with description;
- Approximate amount involved; and
- Parties involved.

The following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during

the year shall be disclosed in the Board's Report:-

- Nature of Fraud with description;
- Approximate Amount involved;
- Parties involved, if remedial action not taken; and
- Remedial actions taken.

MANDATORY ROTATION OF AUDITORS

The concept of mandatory audit rotation is not new. There has been considerable interest in mandatory auditor rotation as a means of strengthening auditor independence, reducing the incidence of audit failure, improving the quality of audit and protecting investors and other users of financial statements. Mandatory audit firm rotation sets a limit on the number of years a public accounting firm may audit a company's financial statements. After a predetermined period, an accounting firm is no longer eligible to serve as the company's auditor for a set time interval and a rotation of firms is required. A mandatory audit rotation rule which sets a limit on the maximum number of years an audit firm can audit a given company's financial statements has been proposed as a means to preserve auditor independence and possibly to increase investors' confidence in financial reports. Mandatory audit firm rotation is defined in the Sarbanes-Oxley (SOX) Act as the imposition of a limit on the period of years during which an accounting firm may be the auditor of record. Mandatory audit firm rotation is often discussed as a potential way to improve audit quality – typically gaining attention when public confidence in the audit function has been eroded by events such as corporate scandals or audit failures

When the same auditors continue in the same company for years and years, it results in a close relationship between management and auditors which increases the chances of fraud. Both Enron and Satyam saw this happen. Hence section 139 of the Companies Act was introduced for mandatory rotation of auditors.

Section 139(2) read with Rule 5 of the Companies (Audit and Auditors) Rules, 2014 –

- No listed company or a company belonging to the following classes of companies excluding one person companies and small companies:-

  a) all unlisted public companies having paid up share capital of rupees 10 crore or more;

  b) all private limited companies having paid up share capital of rupees 20 crore or more;

  c) all companies having paid up share capital of below threshold limit mentioned in (a) and (b) above, but having public borrowings from financial institutions, banks or public deposits of rupees 50 crore or more.

  shall appoint or re-appoint –

  (a) an individual as auditor for more than one term of five consecutive years; and

  (b) an audit firm as auditor for more than two terms of five consecutive years.

- Also, an individual auditor who has completed his term of five consecutive years shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term.
- An audit firm which has completed two terms of five consecutive years, shall not be eligible for re-appointment as auditor in the same company for five years from the completion of such term.
- Provided further that as on the date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years.

The provisions for rotation of auditors can be summarised as under –

In case of an individual as auditor:

(a) No individual shall be appointed or re-appointed as auditor for more than 1 term of 5 consecutive years.

(b) An individual auditor, who has completed his term of 5 consecutive years, shall not be eligible for re-appointment as auditor in the same company for 5 years from the date of completion.

In case of a firm as an auditor:

(a) No audit firm shall be appointed or re-appointed as auditor for more than 2 terms of 5 consecutive years.

(b) An audit firm which has completed its 2 terms of 5 consecutive years, shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of such terms.

(c) *If any firm/LLP which has one or more partners who are also partners in the outgoing audit firm/LLP cannot be appointed as auditors during the 5 year period*. In other words, if two or more audit firms have common partner(s), and one of these firms has completed its 2 terms of 5 consecutive years, none of such audit firms shall be eligible for re-appointment as auditor in the same company for 5 years.

The aforementioned provisions can be explained by the following illustration in a better manner.

If ABC & Co. is auditor of M/S XYZ Ltd. and the balance sheet of M/S XYZ Ltd. is being signed by Mr. A who is also a partner in other firm PQR & Co. If the original tenure of appointment of ABC & Co. is expiring on 20th August, 2020. The firm PQR & Co. can't take the appointment of auditor of M/S XYZ Ltd. for the period of five years starting from 21st August, 2020 and up to 20th August, 2025.

In the above example, PQR & Co. can take the advantage of being appointed as auditor on a date starting after the expiry of financial year 2020-2021. In simple words, PQR & Co. is being eligible for appointment of auditor of M/S XYZ Ltd. after the start of new financial year from the expiry of original tenure of ABC & Co., as the proviso mentions only of one preceding financial year.

AUDITING STANDARDS

The Standards on Auditing have been accorded legal sanctity in the under the Companies Act 2013. Auditors are now mandatorily bound by to ensure compliance with Standards on Auditing.

As per Section 143(2) of the Companies Act 2013, the auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made thereunder or under any order made under sub-section (11) and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

As per Section 143(9) of the Companies Act 2013, it is the duty of every auditor to comply with the auditing standards.

The Section 143(10) confers power to the Central Government to prescribe the standards of auditing as recommended by the Institute of Chartered Accountants of India in consultation with the National Financial Reporting Authority:

However, until any auditing standards are notified, any standard or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards.

INTERNAL AUDIT

"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. "

The Institute of Internal Auditors

The **demand for auditing both external and internal** is sourced in the need to have some means of independent verification to reduce record-keeping errors, asset misappropriation, and fraud within business and non-business organizations. The concept of internal auditing evolved as an **extension to external audit** in testing the reliability of accounting records that contribute to published financial statements. International financial scandals and recent events including global financial crises have emphasised **need for internal auditing** within corporate governance structures of organisations. As organisations and the world they operate in are becoming more and more complex, internal **audit is considered good practice** & advisable as part of underlying internal control & risk management framework of an organisation.

Internal Audit is an independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity including entity's strategic risk management and internal control system.

An effective internal audit function can play a significant role within the corporate governance framework of a company. Over the last decade internal audit has developed and grown in importance. Efficient internal audit functions provide objective assurance/assessments to the board (and to the audit committee) about the adequacy and effectiveness of the processes by which risks are identified and prioritised; managed, controlled, and mitigated.

In most countries and business sectors internal audit reports professionally to an audit committee and managerially to the chief executive or chief financial officer. Internal audit is an independent and objective appraisal function; it supports senior management and the (management) board. Internal audit activities are performed in diverse legal and cultural environments; within organisations that vary in size and structure. Internal audit functions should comply with the relevant professional standards.

Internal Audit is an independent appraisal activity within an organization for the review of systems, procedures, practices, compliance with policies for accounting, financial and other operations as a basis for service to management. It is a tool of control -

- To measure and evaluate the effectiveness of the working of an organization
- To ensure that all the laws, rules and regulations governing the operations of the organization are adhered to
- To identify risks and also suggests remedial measures, thereby acting as a catalyst for change and action.

Section 138 of the Companies Act, 2013 provides for the mandatory appointment of an internal auditor who shall either be a chartered accountant or a cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities for classes of company as specified in the below chart.

every listed company,

every unlisted public company having –

- paid up share capital of fifty crore rupees or more during the preceding financial year; or
- turnover of two hundred crore rupees or more during the preceding financial year; or
- outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
- outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and

every private company having –

- turnover of two hundred crore rupees or more during the preceding financial year; or
- outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

The internal auditor may or may not be an employee of the company. The Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit.

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. The Secretarial Auditor expresses an opinion as to whether there exist adequate systems and processes in the company commensurate with the size and operations of the company to monitor and ensure compliance with applicable laws, rules, regulations and guidelines. Secretarial Audit helps to detect the instances of non-compliance and facilitates taking corrective measures. It audits the adherence of good corporate practices by the company. It is therefore an independent and objective assurance intended to add value and improve operations of the Company. It helps to accomplish the organisation's objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control, and governance processes. Secretarial Audit thus 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.

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. The Secretarial Audit provides an in-built mechanism for enhancing corporate compliance generally and helps to restore the confidence of investors in the capital market through greater transparency in corporate functioning.

Only a member of the Institute of Company Secretaries of India holding certificate of practice (Company secretary in practice) can conduct Secretarial Audit and furnish the Secretarial Audit Report to the company. [Section 204(1) of Companies Act, 2013]

As per section 204(1) of Companies Act, 2013 read with rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the following companies are required to obtain Secretarial Audit Report:

- 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.

"Turnover" means the aggregate value of the realisation of amount made from the sale, supply or distribution of goods or on account of services rendered, or both, by the company during a financial year. [Section 2(91)]

Regulation 24A of SEBI (LODR) regulations, 2015 provides that, every listed entity and its material unlisted subsidiaries incorporated in India shall undertake secretarial audit and shall annex with its annual report, a secretarial audit report, given by a company secretary in practice, in such form as may be specified with effect from the year ended March 31, 2019.

CONSTITUTION OF NATIONAL FINANCIAL REPORTING AUTHORITY (NFRA)

The National Financial Reporting Authority (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.

In accordance with provisions of section 132 of the Companies Act, 2013 and rules to be made thereunder, National Financial Reporting Authority (NFRA) would perform the functions relating to making recommendation on framing accounting and auditing policies/standards, monitoring and enforcing compliance with such standards, overseeing quality of service of auditing profession and investigating and ordering action against professional and other misconduct as provided under the Act.

The Authority shall have power to monitor and enforce compliance with accounting standards and auditing standards, oversee the quality of service under sub-section (2) of section 132 or undertake investigation under sub-section (4) of such section of the auditors of the following class of companies and bodies corporate, namely:-

(a) companies whose securities are listed on any stock exchange in India or outside India;

(b) unlisted public companies having paid-up capital of not less than rupees five hundred crores or having annual turnover of not less than rupees one thousand crores or having, in aggregate, outstanding loans, debentures and deposits of not less than rupees five hundred crores as on the 31st March of immediately preceding financial year;

(c) insurance companies, banking companies, companies engaged in the generation or supply of electricity, companies governed by any special Act for the time being in force or bodies corporate incorporated by an Act in accordance with clauses (b), (c), (d), (e) and (f) of sub-section (4) of section 1 of the Act;

(d) any body corporate or company or person, or any class of bodies corporate or companies or persons, on a reference made to the Authority by the Central Government in public interest; and

(e) a body corporate incorporated or registered outside India, which is a subsidiary or associate company of any company or body corporate incorporated or registered in India as referred to in clauses (a) to (d), if the income or net worth of such subsidiary or associate company exceeds twenty per cent. of the consolidated income or consolidated net worth of such company or the body corporate, as the case may be, referred to in clauses (a) to (d).

Functions and duties of the Authority: The Authority shall protect the public interest and the interests of

investors, creditors and others associated with the companies or bodies corporate governed under rule 3 by establishing high quality standards of accounting and auditing and exercising effective oversight of accounting functions performed by the companies and bodies corporate and auditing functions performed by auditors. The Authority shall:-

(a) maintain details of particulars of auditors appointed in the companies and bodies corporate specified in rule 3;

(b) recommend accounting standards and auditing standards for approval by the Central Government;

(c) monitor and enforce compliance with accounting standards and auditing standards;

(d) oversee the quality of service of the professions associated with ensuring compliance with such standards and suggest measures for improvement in the quality of service;

(e) promote awareness in relation to the compliance of accounting standards and auditing standards;

(f) co-operate with national and international organisations of independent audit regulators in establishing and overseeing adherence to accounting standards and auditing standards; and

(g) perform such other functions and duties as may be necessary or incidental to the aforesaid functions and duties.

Monitoring and enforcing compliance with accounting standards –

- For the purpose of monitoring and enforcing compliance with accounting standards, the Authority may review the financial statements of such company or body corporate, as the case may be, and if so required, direct such company or body corporate or its auditor by a written notice, to provide further information or explanation or any relevant documents relating to such company or body corporate, within such reasonable time as may be specified in the notice.
- The Authority may require the personal presence of the officers of the company or body corporate and its auditor for seeking additional information or explanation in connection with the review of the financial statements of such company or body corporate.
- The Authority shall publish its findings relating to non-complainces on its website and in such other manner as it considers fit, unless it has reasons not to do so in the public interest and it records the reasons in writing.
- Where the Authority finds or has reason to believe that any accounting standard has or may have been violated, it may decide on the further course of investigation or enforcement action through its concerned Division.

Monitoring and enforcing compliance with auditing standards –

(1) For the purpose of monitoring and enforcing compliance with auditing standards under the Act by a company or a body corporate governed under rule 3, the Authority may:

   (a) review working papers (including audit plan and other audit documents) and communications related to the audit;

   (b) evaluate the sufficiency of the quality control system of the auditor and the manner of documentation of the system by the auditor; and

   (c) perform such other testing of the audit, supervisory, and quality control procedures of the auditor as may be considered necessary or appropriate.

(2) The Authority may require an auditor to report on its governance practices and internal processes designed to promote audit quality, protect its reputation and reduce risks including risk of failure of the

auditor and may take such action on the report as may be necessary.

(3) The Authority may seek additional information or may require the personal presence of the auditor for seeking additional information or explanation in connection with the conduct of an audit.

(4) The Authority shall perform its monitoring and enforcement activities through its officers or experts with sufficient experience in audit of the relevant industry.

(5) The Authority shall publish its findings relating to non-complainces on its website and in such other manner as it considers fit, unless it has reasons not to do so in the public interest and it records the reasons in writing.

(6) The Authority shall not publish proprietary or confidential information, unless it has reasons to do so in the public interest and it records the reasons in writing.

(7) The Authority may send a separate report containing proprietary or confidential information to the Central Government for its information.

(8) Where the Authority finds or has reason to believe that any law or professional or other standard has or may have been violated by an auditor, it may decide on the further course of investigation or enforcement action through its concerned Division.

Overseeing the quality of service and suggesting measures for improvement –

(1) On the basis of its review, the Authority may direct an auditor to take measures for improvement of audit quality including changes in their audit processes, quality control, and audit reports and specify a detailed plan with time-limits.

(2) It shall be the duty of the auditor to make the required improvements and send a report to the Authority explaining how it has complied with the directions made by the Authority.

(3) The Authority shall monitor the improvements made by the auditor and take such action as it deems fit depending on the progress made by the auditor.

(4) The Authority may refer cases with regard to overseeing the quality of service of auditors of companies or bodies corporate referred to in rule 3 to the Quality Review Board constituted under the Chartered Accountants Act, 1949 (38 of 1949) or call for any report or information in respect of such auditors or companies or bodies corporate from such Board as it may deem appropriate.

(5) The Authority may take the assistance of experts for its oversight and monitoring activities.

Powers of NFRA

Apart from making recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards, the NFRA will have the investigative and disciplinary powers. NFRA can:

1. investigate either suo moto or on the reference made to it by Central Govt. into the matters of professional or other misconduct, committed by any member or firm of chartered accountants, registered under the Chartered Accountants Act, 1949.
2. impose penalties of not less than 1 lakh which may extend to five times of the fees received, in case of individuals professionals and of not less than 10 lakhs which may extend to ten times of the fees received, in case of professional firms; IF the misconduct is proved.
3. debarring the member or the firm from engaging himself or itself from practice as the member of the Institute of Chartered Accountant of India for a minimum period of six months which may extend to a period of 10 years.

4. NFRA has been vested with the same powers as are vested in civil courts under the Code of Civil Procedure, 1908 while trying a suit, relating to:
    - discovery and production of books of account and other documents, as may be specified by the National Financial Reporting Authority;
    - summoning, enforcing the attendance of persons and examination them on oath;
    - issuing commissions for the examination of witnesses or documents;
    - inspection of any books, registers and other documents of any person to whom NFRA has summoned, enforced the attendance and examined on oath;

It is also being provided in section 132 of the Act that no other institute or body shall initiate or continue any proceedings in such matters of misconduct where the NFRA has initiated an investigation under this section. However, any person aggrieved by any order of the NFRA may appeal before the Appellate Authority constituted for this purpose. The NFRA have the power to investigate, either suo moto or on a reference made to it by the Central Government, for such class of bodies corporate or persons, in such manner as may be prescribed into the matters of professional or other misconduct committed by any member or firm of **chartered accountants**. And no other institute or body shall commence or continue any proceedings in such matters of delinquency or misconduct where the National Financial Reporting Authority has initiated an investigation.

RELATED PARTY TRANSACTIONS

A related party transaction can present a potential or actual conflict of interest and might not be aligned with the best interests of the company and its shareholders, especially minority shareholders. It can result in situations where such transactions are used as a conduit to channel funds out of the company into another entity which is a “related party.” These transactions can also be considered as a business opportunity that is lost to a related party to the detriment of the interests of the company and its shareholders. Thus, these conflicts of interest are inherently linked to the governance structure of a company, which can either enhance or limit the board’s effectiveness. The board carries the main responsibility for reviewing and guiding corporate strategy and for effectively monitoring management, and is accountable to the company and its shareholders.

Not all RPTs are detrimental to the interest of the company or its shareholders. Some transactions can be legitimate and serve practical, commercial purposes. If companies are prohibited from entering into such transactions, their ability to maximise shareholder value can suffer. Some related party transactions are conducted for the purpose of exchanging products or services, which should occur at an arm’s length basis. Some products or services do not have comparable benchmarks in the marketplace, however, as they are available only within a closed group. For example, a pharmaceutical conglomerate holds all of its patents with one company. If other companies have to manufacture those products, they might have no choice but to transact with the related party for using such rights. In that case, there might not be any transaction available in the marketplace that can serve as a useful benchmark to assess whether the transactions was conducted at arm’s length.

The various types of RPTs that are commonly observed are:

- Financial assistance through provisions of loans, guarantees and collateral
- Asset sales and purchases between related parties
- The sale, purchase or supply of any goods, materials or services in the ordinary course of business
- Bailouts

The law in India does not prohibit RPTs. Instead, the law puts into place a system of checks and balances, such as requirements for approval from the board of directors/shareholders, timely disclosures and prior statutory approvals, to ensure that the transactions are conducted within appropriate boundaries. RPTs are required to

be managed transparently, so as not to impose a heavy burden on a company's resources, affect the optimum allocation of resources, distort competition or siphon off public resources.

The requirements concerning related party transactions under Companies Act 2013 and SEBI (LODR) Regulations, 2015 may be divided into four key parts, viz.,

- Identification of Related Parties
- Identification of Related Party Transactions
- Approval Process
- Disclosure requirements

Identification of Related Parties

According to Section 2(76) of Companies Act 2013, "related party", with reference to a company, means—

(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 is a member or director;

(v) a public company in which a director or manager is a director or holds along with his relatives, more than two per cent. (2%) 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 company which is –

- a holding, subsidiary or an associate company of such company; or
- a subsidiary of a holding company to which it is also a subsidiary;

(ix) such other person as may be prescribed;

Rule 3 of the Companies (Specification of Definitions Details) Rules 2014 provides that for the purpose of sub-section (ix) of section 2(76), a director other than an independent director or KMP of the holding company or his relative with reference to a company shall be deemed to be related party.

Section 2(77) of the Companies Act, 2013 and rules prescribed there under provides that ''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.

The definition of relative is harmonised under Regulation 2(1)(zd) of Listing Regulations. It provides that Relative means relative as defined under sub-section (77) of section 2 of the Companies Act, 2013 and rules prescribed there under.

Regulation 2(1) (zb) of Listing Regulations defines that "related party" means a related party as defined under sub-section (76) of section 2 of the Companies Act, 2013 or under the applicable accounting standards.

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.

(i) The entity is controlled or jointly controlled by a person identified in (a).

(ii) 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)

Thus, the term 'related party' is broader under listing regulations. The definition includes all related parties under the Act and under Ind AS 24. The definition of 'related party' under listing regulations is likely to result in identification of significantly higher number of related parties vis-à-vis those under the Act. LODR is likely to result in identification of much higher number of related parties and identification on a more consistent basis.

Identification of Related Party Transaction

Section 188 (1) of the Companies Act 2013 deals with the related party transactions with respect to:

- Sale, purchase or supply of any goods or materials
- Selling or otherwise disposing of, or buying, property of any kind
- Leasing of property of any kind

- Availing or rendering of any services
- Appointment of any agent for purchase or sale of goods, materials, services or property
- Related party's appointment to any office or place of profit in the company, its subsidiary company or associate company, and
- Underwriting the subscription of any securities or derivatives thereof, of the company.

Under Regulation 2(1)(zc) of SEBI (LODR) Regulations, 2015 "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.

The regulations define related party transactions in a much general sense (relying on the accounting standards) whereas the Act is much more specific in which transactions it wants to regulate. In the definition under regulations, specific attention is drawn to the use of the word 'resource' which may include even items that do not meet criteria for recognition as an asset. To illustrate, a listed company is transferring to its fellow subsidiary 'research work' carried out in the past which does not meet criteria for recognition as an intangible asset. Under regulations, the proposed transaction will be covered as transfer of resource. Hence, regulations contain a broader definition which is expected to cover all types of related party transactions.

Approval process

Section 188(1) of the Companies Act 2013 provides that a company shall enter into any contract or arrangement with a related party with respect to Related party transactions only with the consent of the Board of Directors given by a resolution at a meeting of the Board and subject to certain conditions as prescribed under Rule 15 of the Companies (Meetings of board and its Powers) Rules, 2014.

The agenda of the Board meeting at which the resolution is proposed to be moved shall disclose-

(a) the name of the related party and nature of relationship;

(b) the nature, duration of the contract and particulars of the contract or arrangement;

(c) the material terms of the contract or arrangement including the value, if any;

(d) any advance paid or received for the contract or arrangement, if any;

(e) the manner of determining the pricing and other commercial terms, both included as part of contract and not considered as part of the contract;

(f) whether all factors relevant to the contract have been considered, if not, the details of factors not considered with the rationale for not considering those factors; and

(g) any other information relevant or important for the Board to take a decision on the proposed transaction.

Also except with the prior approval of the company by a resolution, a company shall not enter into a transaction or transactions, where the transaction or transactions to be entered into –

(a) as contracts or arrangements with respect to clauses (a) to (e) of sub-section (1) of section 188, with criteria as mentioned here-	(i) sale, purchase or supply of any goods or material, directly or through appointment of agent, [amounting to ten percent or more] of the turnover of the company or rupees one hundred crore, whichever is lower, as mentioned in clause (a) and clause (e) respectively of sub-section (1) ofsection 188; (ii) selling or otherwise disposing of or buying property of any kind, directly or through appointment of agent, 3[amounting to ten percentor more] of net worth of the company or rupees one hundred crore, whichever is lower, as mentioned in clause (b) and clause (e) respectively of sub-section (1) of section 188; (iii) leasing of property any kind 4[amounting to ten percent or more] of the net worth of company or 3[ten per cent or more of turnover] of the company or rupees one hundred crore, whichever is lower, as mentioned in clause (c) of sub-section (1) of section 188; (iv) availing or rendering of any services, directly or through appointment of agent, 3[amounting to ten percent or more] of the turnover of the company or rupees fifity crore, whichever is lower as mentioned in clause (d) and clause (e) respectively of sub-section (1) of section 188: Explanation.- It is hereby clarified that the limits specified in sub-clause (i) to (iv) shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year.
(b) is for appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding two and a half lakh rupees as mentioned in clause (f) of sub-section (1) of section 188.	
(c) is for remuneration for underwriting the subscription of any securities or derivatives thereof, of the company exceeding one percent of the net worth as mentioned in clause (g) of sub-section (1) of section 188.	Explanation.- (1) The turnover or net worth referred in the above sub-rules shall be computed on the basis of the audited financial statement of the preceding financial year.

- In case of wholly owned subsidiary, the resolution passed by the holding company shall be sufficient for the purpose of entering into the transaction between the wholly owned subsidiary and the holding company.
- Where any contract or arrangement is entered into by a director or any other employee, without obtaining the consent of the Board or approval by a resolution in the general meeting and if it is not

ratified by the Board or, as the case may be, by the shareholders at a meeting within three months from the date on which such contract or arrangement was entered into, such contract or arrangement shall be voidable at the option of the Board or, as the case may be, of the shareholders] and if the contract or arrangement is with a related party to any director, or is authorised by any other director, the directors concerned shall indemnify the company against any loss incurred by it.

Provisions under SEBI (LODR) Regulations, 2015

Policy on materiality of related party transactions : Regulation 23(1)- The listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions including clear threshold limits duly approved by the board of directors and such policy shall be reviewed by the board of directors at least once every three years and updated accordingly.

When will a transaction with a related party be material?

Regulation 23(1) and (1A)- 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. With effect from July 01, 2019, 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.

Approval of Audit Committee

Regulation 23(2)- All related party transactions shall require prior approval of the audit committee.

Omnibus Approval :

Regulation 23(3) - 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 that 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:

Approval of the shareholders

Regulation 23(4) - All material related party transactions shall require approval of the shareholders through resolution and no related party shall vote to approve such resolutions whether the entity is a related party to the particular transaction or not:

Provided that the requirements specified under this sub-regulation shall not apply in respect of a resolution plan approved under section 31 of the Insolvency Code, subject to the event being disclosed to the recognized stock exchanges within one day of the resolution plan being approved;

Exemptions

Regulation 23 (5) - The provisions of Regulation 23 (2), (3) and (4) shall not be applicable 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.

Explanation. - For the purpose of clause (a), "government company(ies)" means Government company as defined in sub-section (45) of section 2 of the Companies Act, 2013.

Other provisions

- Regulation 23 (6) The provisions of this regulation shall be applicable to all prospective transactions.
- Regulation 23 (7) For the purpose of this regulation, all entities falling under the definition of related parties shall not vote to approve the relevant transaction irrespective of whether the entity is a party to the particular transaction or not.
- Regulation 23 (8) 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.
- Regulation 23 (9) 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.

The relevant disclosures to be made under Related Party transactions have already been covered in the previous chapter.

VIGIL MECHANISM / WHISTLE BLOWER

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

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.

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 Nabraska 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 Fortune500 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.

GLOSSARY

- **Audit**: An official inspection of an organization's accounts, typically by an independent body.
- **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.
- 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 organisation.

LESSON ROUND UP

- 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
  - Appropriate Remuneration
  - Restriction on Non- Audit Services
- To improve financial reporting standards India has revised its accounting standards. The new Ind-AS is in line with the International Financial Reporting standard.
- 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 Section 132 of the Act to oversee the auditing profession, improve the quality of audit and ensure independence of audit firms.
- 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.

SELF TEST QUESTIONS

(*These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation*)

1. Suggest some measures to increase auditors' effectiveness?
2. What are the powers and functions of NFRA?
3. Write the provisions for mandatory rotation of auditors in India.
4. Does having an independent audit prevent scams? Justify your answer.
5. Write a short note on Internal Audit.
6. Explain in brief the provisions and importance of secretarial audit.

Lesson 8

Corporate Governance and Shareholders Rights

LESSON OUTLINE

- Introduction
- Rights of Shareholders
- Promoter / Controlling Shareholder
- Role and Liabilities of Promoters
- Majority and Minority Shareholders
- Protection of rights of shareholders/ investors in India
- IEPF
- Investor Associations
- Protection of Rights of Minority Shareholders
  - Oppression and Mismanagement
  - Class Action Suits
  - Others
- Institutional Investors
  - UK Stewardship Code
  - Principles for Responsible Investment (PRI)
  - Code for Responsible Investing in South Africa (CRISA)
  - California Public Employees' Retirement System
- Role of Proxy Advisors
- Governance of Group Entities/ Subsidiaries
- Corporate Governance in Family owned enterprises
- 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 and the provisions in the Companies Act, 2013 and SEBI Regulations 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 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.

Also the role of proxy advisors, and corporate governance in subsidiaries and family owned enterprises have been discussed.

Shareholders have the right and obligation to set the parameters of corporate behavior within which management pursues profit.

– Eliot Spitzer

INTRODUCTION

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 there with 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.

RIGHTS OF SHAREHOLDERS

Under the Companies Act, 2013

S.No.	Rights of Shareholder	Section
1. Right to receive copies of the following documents:		
i	Abridged balance-sheet and profit and loss account in the case of a listed company and balance-sheet and profit and loss account otherwise.	136
ii	Contract for the appointment of the Managing Director / Manager	190
iii	Notices of the general meetings of the company	101
2. Right to inspect statutory registers/returns and get copies thereof on payment of prescribed fees.		
i	Debenture Trust Deed	71, 71(13)
ii	Register of Charges	87
iii	Register of Members and Debenture holders and Index Registers, Annual Returns	94
iv	Minutes of General Meetings	119
v	Register of Contracts	189
vi	Register of Director's Shareholding	170
vii	Copy of Agreement of appointment of the Managing Director/ Manager	190

3. Right to attend Meetings of the Shareholders and exercise voting rights at these meetings either personally or through proxy.		96, 100, 105 and 107
4. Other Rights:		
i	To receive share certificates as title of their holdings	46
ii	To transfer shares	44 56
iii	To received dividend when declared	
iv	To have right shares	62
v	To appoint directors	140
vi	To share the surplus assets on winding up	48
vii	Right to be exercised collectively in respect of making application to the Central government for investigation of the affairs of the company.	210
viii	Right to make application collectively to the Company Law Board/ Tribunal for oppression and mismanagement	241 242
ix	Right of Nomination	72
x	Right to vote in proportion to his share of the paid- up equity share capital of the company	47
xi	Variation of Shareholder's right	46, 48
5. In case of winding up:		
i	Winding up of a company in case of oppression and mismanagement	241 242

Rights of shareholders under SEBI (LODR) Regulations, 2015

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 which are already discussed in Lesson 2 of this Study material.

PROMOTER / CONTROLLING SHAREHOLDER

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***

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 prostecus, 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 Regualtion 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;

Role and Liabilities of 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)
- **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.
- **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.
- **Co-operate with Official Liquidator**: Section 284 deals in the matters relating to "Promoters, directors, etc., to cooperate with Company Liquidator". Its sub-seciton (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.
- **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)

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.

Also, more often 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 on 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.

PROTECTION OF RIGHTS OF SHAREHOLDERS/INVESTORS 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
- 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).
- Securities and Exchange Board of India (Investor Protection and Education Fund) Regulations, 2009 to establish a Fund to be called the Investor Protection and Education Fund.

INVESTOR EDUCATION & PROTECTION FUND

Investor Education and Protection Fund (IEPF) is established for promotion of investors' awareness and protection of the interests of investors under the provisions of section 125 of the Companies Act, 2013.

The IEPF Authority is entrusted with the responsibility of administration of the Investor Education Protection Fund (IEPF), make refunds of shares, unclaimed dividends, matured deposits/debentures etc. to investors and to promote awareness among investors.

As per Section 125(2) of the Companies Act 2013, following shall be credited to the Fund

(a) the amount given by the Central Government by way of grants after due appropriation made by Parliament by law in this behalf for being utilised for the purposes of the Fund;

(b) donations given to the Fund by the Central Government, State Governments, companies or any other institution for the purposes of the Fund;

(c) the amount in the Unpaid Dividend Account of companies transferred to the Fund under sub-section (5) of section 124;

(d) the amount in the general revenue account of the Central Government which had been transferred to that account under sub-section (5) of section 205A of the Companies Act, 1956, as it stood immediately before the commencement of the Companies (Amendment) Act, 1999, and remaining unpaid or unclaimed on the commencement of this Act;

(e) the amount lying in the Investor Education and Protection Fund under section 205C of the Companies Act, 1956;

(f) the interest or other income received out of investments made from the Fund;

(g) the amount received under sub-section (4) of section 38;

(h) the application money received by companies for allotment of any securities and due for refund;

(i) matured deposits with companies other than banking companies;

(j) matured debentures with companies;

(k) interest accrued on the amounts referred to in clauses (h) to (j);

(l) sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years;

(m) redemption amount of preference shares remaining unpaid or unclaimed for seven or more years; and

(n) such other amount as may be prescribed: Provided that no such amount referred to in clauses (h) to (j) shall form part of the Fund unless such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment.

Section 125(3) -the Fund shall be utilised for –

- The refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon

- Promotion of investors' education, awareness and protection
- Distribution of any disgorged amount among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made by the Court which had ordered disgorgement
- Reimbursement of legal expenses incurred in pursuing class action suits under sections 37 and 245 by members, debenture-holders or depositors as may be sanctioned by the Tribunal and

INVESTOR ASSOCIATIONS

SEBI as a part of undertaking various investor awareness and education activities, has recognised organisations working in the area of investor education / awareness, conducting awareness workshops and rendering assistance to individuals/investors in the area of grievance redressal as "Investors' Associations".

The recognized Investors' Associations supplements SEBI's initiatives in the area of Investor Education and Protection. SEBI has issued "Operational Guidelines (Investors' Associations), 2019" to facilitate and regulate the functioning of SEBI recognised Investors' Associations which came into force from February 1, 2019.

"Recognised Investors' Association" means an entity rendering services in the area of investor education and awareness, conducting awareness workshops and assisting individuals/investors in redressal of their grievances and recognized by SEBI as an Investors' Association. The Investors' Association shall conduct workshops under SEBI IEPF in the state in which their registered office is located subject to prior approval from the respective SEBI office at least 5 working days prior to date of the workshop. The Investors' Associations are eligible to claim reimbursement of the expenses incurred from SEBI subject to the conditions specified.

PROTECTION OF RIGHTS OF MINORITY SHAREHOLDERS

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

Companies Act, 2013 provides for some measures to protect the interest of minority shareholders which are discussed below-

1) **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.

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.

2) **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.

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."

A balance is to be struck between the rule of the majority and the rights of the minority. The fundamental principle on which shareholders democracy is based is that the rule of majority shall prevail. However, it is also necessary to ensure that this power of the majority is placed within reasonable bounds and does not result in oppression of the minority and mismanagement of the company. Therefore special provisions have been provided in the Companies Act for minority shareholders to voice their opinions and protect their interests.

3) **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.

4) **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)

5) **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.

6) **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).

7) **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. Majority Shareholders being interested party will not be able to vote so the minority shareholders will have the final say. (Sec 188)

8) **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.

INSTITUTIONAL INVESTORS AND THEIR ROLE IN PROMOTING GOOD CORPORATE GOVERNANCE

Institutional investors are those financial institutions which accept funds from other parties for investment by the institution in its own name but on their clients/beneficiaries behalf. The different kinds of institutional investors are banks, development financial institutions, insurance companies, mutual funds, foreign institutional investor, provident funds and proposed private fund managers. They are now significant players in the global economy.

Institutional investors are entrusted with funds from the public and most of the household income is with these institutional investors. They are safe keepers of public money and act in a fiduciary capacity. They are obligated to take decisions which best serve the companies' interests and steer the company to function in an ethical manner.

There is a mutual relationship between institutional investors and the corporate governance of a company. The corporate governance practices followed by a company are very important to determine the number of institutional investors who would like to invest in the firm and the extent to which they would like to invest.

Most governance sensitive institutional investors would like to invest in firms which already have their governance mechanisms in place. Institutions with corporate governance mechanisms in place are better to invest in as this would mean decreased monitoring costs. The institutional investors would not have to play a proactive role in monitoring the practices followed by the company.

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.

The OECD principles have advocated increased awareness amongst institutional shareholding and increased participation of investors in the affairs of the company. 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. It is increasingly common for shares to be held by institutional investors. The effectiveness and credibility of the entire corporate governance system and company oversight will, therefore, to a large extent depend on institutional investors that can make informed use of their shareholder rights and effectively exercise their ownership functions in companies in which they invest. While this principle does not require institutional investors to vote their shares, it calls for disclosure of how they exercise their ownership functions with due consideration to cost effectiveness. For institutions acting in a fiduciary capacity, such as pension funds, mutual investment schemes and some activities of insurance companies, the right to vote can be considered part of the value of the investment being

undertaken on behalf of their clients. Failure to exercise the ownership rights could result in a loss to the investor who should therefore be made aware of the policy to be followed by the institutional investors.

The incentives for intermediary owners to vote their shares and exercise key ownership functions may under certain circumstances differ from those of direct owners. Such differences may sometimes be commercially sound but may also arise from conflicts of interest which are particularly acute when the fiduciary institution is a subsidiary or an affiliate of another financial institution, and especially an integrated financial group. When such conflicts arise from material business relationships, for example, through an agreement to manage the portfolio company's funds, market integrity would be enhanced if they are identified and disclosed. At the same time, institutions should disclose what actions they are taking to minimise the potentially negative impact on their ability to exercise key ownership rights. Such actions may include the separation of bonuses for fund management from those related to the acquisition of new business elsewhere in the organisation.

Institutional investors are subject to widely varying levels of regulation. Apart from the regulatory framework, in recent years, a number of jurisdictions have introduced professional codes of behaviour for institutional investors. Some of them are discussed below.

UK Stewardship Code

The Stewardship Code is a part of UK company law concerning principles that institutional investors are expected to follow. Stewardship aims to promote the long term success of companies in such a way that the ultimate providers of capital also prosper.

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 fulfilment of its responsibilities.

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.

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.

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.

The Principles of the Code

So as to protect and enhance the value that accrues to the ultimate beneficiary, 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.

Principles for Responsible Investment (PRI)

Responsible investment is an approach to investing that aims to incorporate environmental, social and governance (ESG) factors into investment decisions, to better manage risk and generate sustainable, long-term returns. The PRI is the world's leading proponent of responsible investment.

It works to understand the investment implications of environmental, social and governance (ESG) factors and to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The PRI is truly independent. It encourages investors to use responsible investment to enhance returns and better manage risks, but does not operate for its own profit; it engages with global policymakers but is not associated with any government; it is supported by, but not part of, the United Nations.

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.

Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.

Principle 2: We will be active owners and incorporate ESG issues into ownership policies and practices.

Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which they invest.

Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.

Principle 5: We will work together to enhance effectiveness in implementing the Principles.

Principle 6: We will each report on their activities and progress towards implementing 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.

Principles –

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.

Principle 2 : An institutional investor should demonstrate its acceptance of ownership responsibilities in its investment arrangements and investment activities.

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.

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.

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.

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 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.
10. **Transparency**: Financial transparency, including elements of a free press, is necessary for investors to have truthful, accurate and relevant information.
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.
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.
13. **Market Regulation and Liquidity** : Little to no repatriation risk. Potential market and currency volatility are adequately rewarded.
14. **Capital Market Openness** : Free market policies, openness to foreign investors, and legal protection for foreign investors.
15. **Settlement Proficiency/Transaction Costs**: Reasonable trading and settlement proficiency and reasonable transaction costs.
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.

DEALING WITH INSTITUTIONAL INVESTORS

Companies should consider implementing the following practices, while dealing with institutional 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.

ROLE OF PROXY ADVISORY FIRMS

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.

GOVERNANCE OF GROUP ENTITIES/ SUBSIDIARIES

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 voting agreements or in any other manner". In the above case H is the holding company and S the subsidiary company.

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.

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.

CORPORATE GOVERNANCE IN FAMILY OWNED 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. Strong governance measures in a family owned business can effectively act as a prevention mechanism against a lot of tensions that may arise between family members at a later stage. It is also imperative for family businesses to adopt effective corporate governance measures in order to be a tough competition to other players in the global market.

The most glaring characteristic of a family owned business is that all the key managerial positions in such businesses are held by family members. Non-family members may of course be employees of the company, but the decision-making power usually vests with the members of the family. 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.

Family businesses are generally 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. Howevr, 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.

Certain provisions of Corporate Governance in a Family Owned Companies have been actively statutorily incorporated in the Companies Act, 2013 such as:

- **Independent Directors and Women Directors** : To build up the transparency and accountability of the Board of Directors, the Act now requires at least 1/3rd of the total directors of a listed company to be Independent Directors and have no material or pecuniary relationship with the company or related persons. Public companies with paid up share capital exceeding Rs. 10 Crores or turnover exceeding Rs. 100 crore are statutorily required to have at least 2 directors as Independent Directors.

  To ensure diversity on the board, all listed companies and non-listed companies having paid up share capital more than Rs. 100 Crores and turnover exceeding Rs. 100 Crores are required to have at least one woman director on the board.

- **Corporate Social Responsibility** : Every company having net worth of Rs. 500 Crores or more, turnover exceeding Rs. 1000 Crores or net profit of more than Rs. 5 Crore is required to constitute a Corporate Social Responsibility Committee under Section 135 of the Companies Act, 2013 constituting 3 or more directors with at least 1 Independent Director to formulate policies and recommend activities that the company may undertake for promotion of education, gender equality, health, poverty eradication, environment, employment etc. Again, this measure puts responsibility on the company for the social wellbeing not just of its workforce, but also makes it publicly accountable.

- **Audit Committee** : The Act provides for the setting up of an Audit Committee comprising of at least 3 directors by all listed companies, majority of which have to be independent directors. The members of such a committee have to be persons who can read and understand financial statements and the task entrusted to such a committee is recommending remuneration and appointments of auditors and reviewing their independence.

- **Nomination and Remuneration Committee** : The Nomination and Remuneration committee shall comprise of 3 or more non-executive directors out of which at least half shall be Independent Directors. Such committee shall identify persons qualified to become directors of the company and make recommendations to the board of directors regarding their appointment and approval.
- **Serious Fraud Investigation Office** : Section 211 of the Act provides for the establishment of a Serious Fraud Investigation Office to look into the affairs of the company and investigate incidences of fraud upon receipt of report of the Registrar or inspector or generally in the public interest or request from any Department of Central or State Government.

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.

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

– **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 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.

SELF TEST QUESTIONS

(*These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation*)

1. Discuss about the provisions for protection of 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. Write a short note on IEPF.
5. Write a note on Oppression and mismanagement.

Lesson 9

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
- 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.

Creating a strong company culture isn't just good business. It's the right thing to do, and it makes your company better for all stakeholders - employees, management, and customers.

– Julia Hartz

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 Freeman[1], 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 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.

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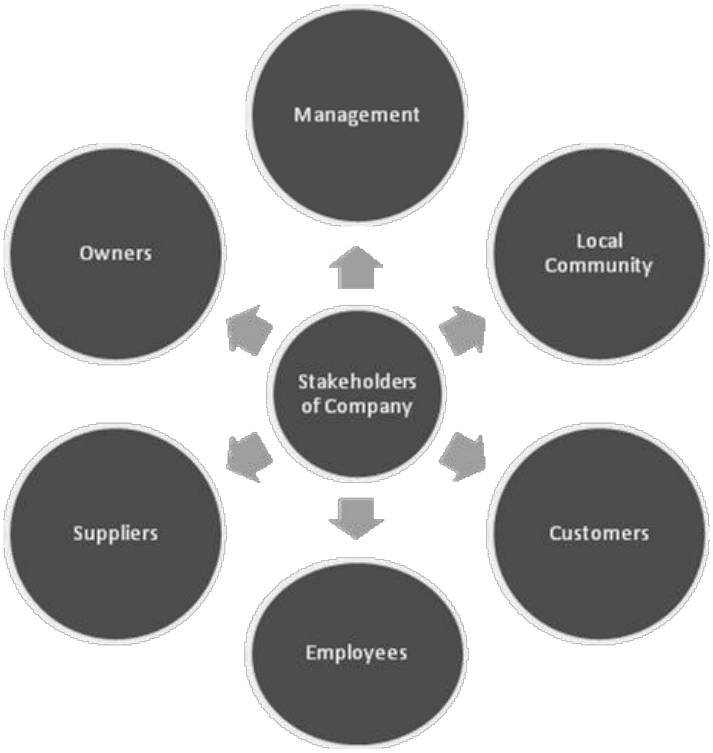
1 R. Edward Freeman is a professor at the Darden School of the University of Virginia. He is the author of several books on Stakeholder Management including the influential Strategic Management: A Stakeholder Approach.



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 in1986 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.

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**: Manages 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 mismanagement 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.

(b) 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.

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 is 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.
- Clarkson 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 10
Governance and Compliance Risk

LESSON OUTLINE

- Introduction
- Compliance Risk
- Consequences/ Risks of Non-Compliance
- Compliance Risk Management
- Steps in Compliance Risk Management
- Compliance Risk Mitigation
- Essentials of a Successful Compliance-Risk Management Program
- New Developments- Governance and Risk Compliance (GRC)
- Conclusion
- Glossary
- LESSON ROUND-UP
- SELF TEST QUESTIONS

LEARNING OBJECTIVES

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. The objective of this study lesson is to enable the students to understand the concept of compliance risk and consequences of non-compliance. This chapter also explains about compliance risk management, steps for compliance risk management and mitigation of compliance risks.

It also deals about 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.

"The risk management needs to lift up from risk control to risk intelligence which can identify the potential business growth opportunities."

– Pearl Zhu

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.

In the current globalised world, 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 consumerisation. 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.

Today, corporations and government agencies are facing an unprecedented wave of regulatory obligations and increased penalties for non-compliance. The financial services sector, as an example, needs to comply with a myriad of prudential regulations, RBI laws, AML compliances, consumer credit and protection laws to name a few. 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.

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

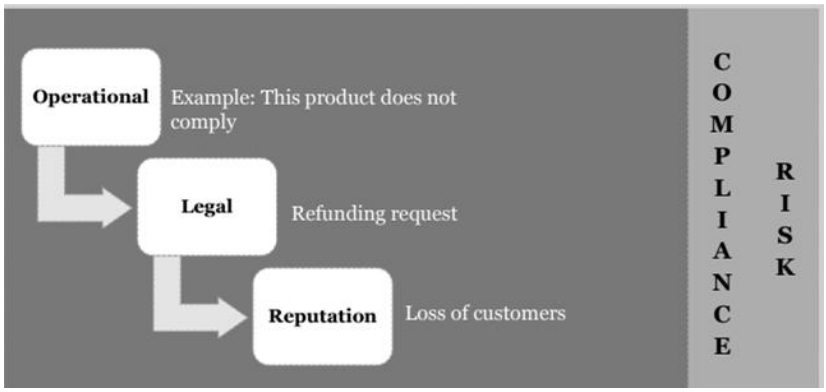
costly and damaging to an organisation and the custodians of governance within the organisation.

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

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.

This risk is closely interconnected with the operational risk, legal and reputation, so that from one follows the other.



Compliance risk is the threat posed to a company's earnings or capital as a result of violation or non conformance with laws, regulations, or prescribed practices. Companies that fail to comply with the necessary standards may be subjected to fines, payment of damages, and voided contracts. This, in turn, can lead to diminished reputation and limited business opportunities as the company finds its franchises reduced in value and its potential for expansion curtailed. In extreme cases, the company may find it is no longer capable of enforcing its contracts.

CONSEQUENCES/ RISKS OF NON-COMPLIANCE

Failing to comply with rules, regulations, and specifications could have costly consequences. In the famous Sahara case, the Group was accused of failing to refund over 200 billion rupees to its more than 30 million small investors that it had collected through two unlisted companies of Sahara. In 2011, SEBI ordered Sahara to refund this amount with interest to the investors, as the issue was not in compliance with the requirements applicable to the public offerings of securities. Later in 2014, Mr Subrata Roy, the chairman of Sahara was arrested for the said fraud. His proposal to settle the matter was rejected by the court and SEBI.

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 risks of non compliance.

1. **Penalties and Fines**: Penalties include financial fines, limitations on activities, additional barriers to approval and even imprisonment. Even if the organization sometimes is not given an actual penalty, an investigation by a government body costs many hours of work and costs in form of potential legal and contractor fees. Penalties for non compliance can lead to the organization's loss of reputation and business opportunities, as well as the devaluation of its franchises. Below are a few examples of penalties imposed under the laws and regulations in India-

   - As per section 88 of the Companies Act 2013, if a company fails to maintain a register of members, the company and every officer of the company in default shall be punishable with a fine ranging from 50,000 rupees to 300,000 rupees. Further, as per section 92 of the Act, if a company fails to file a copy of annual return within the prescribed timeline, the company shall be punishable with a fine ranging from 50,000 rupees to 500,000 rupees.
   - Section 13 of the Foreign Exchange Management Act 1999 imposes a penalty on every person who contravenes any provision of this Act, or contravenes any rule, regulation, notification, direction or order issued in exercise of the powers under this Act, or contravenes any condition subject to which an authorisation is issued by the Reserve Bank. The said penalty can equal up to three times the sum involved in such contravention where the amount is quantifiable, or up to 200,000 rupees where the amount is not quantifiable. Where such contravention continues, further penalties can be levied of up to 5,000 rupees for each day after the first day during which the contravention continues.
   - Section 21 of the Maternity Benefit Act 1961 states that every employer who does not comply with the provisions of the Act shall be punishable with imprisonment of up to three months, with a fine of up to 500 rupees or with both.
   - Section 22A of the Minimum Wages Act 1948 imposes a penalty on every employer who contravenes any provision of this Act or any rule or order made thereunder with a fine of up to 500 rupees.
   - Via its circular dated 15 June 2017, SEBI has imposed certain penalties for non-compliance with certain provisions of the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009, which includes inter alia a penalty of 20,000 rupees a day for delay in completion of bonus issue,

until the date of actual compliance.

- Section 43A of the Competition Act 2002 imposes penalties on any person or enterprise who fails to give notice to the commission with respect to forming a combination. The penalty imposed may extend to one per cent of either the total turnover or the assets, whichever is the higher amount.
- Penalty for non- filing of Income Tax Return attracts interest u/s 234A of the Income Tax Act, 1961 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.
- Penalty for Non- Preparation of Financial Statements 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 under the Companies Act 2013.
- Additional fee is leviable for Non-filing of Annual RoC forms 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.

2. **Criminal Charges**: Criminal charges are a potential consequence for certain regulatory non-compliance. Failure to comply in areas pertaining to staff management, workplace safety, marketing, supply chain, corporate governance, stock management and due diligence laws could result in jail time for director or board member or other officials.

3. **Reputational Damage**: A business' public image is a key to its success. When a company is thrust into the public eye for failing to comply with regulations, there are reputational repercussions, which eventually lead to distrust. Once that happens, loyal customers may leave, new customers may be put off and potentially beneficial partnerships may never develop.

   Today because of the increased awareness and focus on good governance practices, all the stakeholders want to do business with companies practicing legally and ethically. Compliance violations can turn customers or suppliers away which damages the reputation of the company. The companies tend to lose existing customer base and there are few to no new customers to vouch for the trustworthiness of the company. The damage to brand reputation can often cost even more than those fines.

   In the recent probe in the matter pertaining to allegations related to a $500 million loan to Videocon Group by ICICI Bank has put a spotlight on corporate governance at the ICICI Bank and posed risks to its reputation. An investigation into allegations that India's ICICI Bank extended a loan with a potential conflict of interest raises questions over the bank's governance and created severe reputational risks.

   In 2017, one of the top candies and chocolate makers Cadbury India (Mondelez India Foods) paid a consultant who helped them to obtain a license by bribing government officials. This destroyed the reputation of the companies and the company was imposed with sky touching fines.

4. **Access to Markets and Product Delays**: Every country has its own labor and employment laws, and multinational companies are obligated to comply with local laws and regulations also. Also businesses are required to meet a host of regulations if they wish to do business with government. Non-compliance across enterprise and business network could result in exclusion from the tendering processes and supplier databases. In addition, companies that place value on corporate compliance may avoid doing business with companies which are non compliant as they would want to ensure that they meet their own regulatory obligations. Non compliances may also result into financially damaging events like having products/ services blocked at the border, forced to issue a recall or forced to destroy merchandise due to compliance issues etc.

5. **Roadblock in Funding**: The pre-requisite of any funding exercise is the status of tax and regulatory compliances. A company cannot get funded, even in the seed investment level, whose compliances are not upto date. Banks also 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.

Other distinct areas that present risk for non-compliance can also be stated as under

FINANCIAL
- Monetary fines
- End of a business or business line
- Increased capital, liquidity or solvency requirements
- Impact on share price
- Competitive disadvantages
- Opportunity costs of non-compliance

PERSONAL
- Increased personal liability
- Forced changes to senior management
- Need for more highly-priced risk and compliance skills
- Claw-backs invoked on bonuses

OPERATIONAL
- Expensive and time-consuming remedial actions including redress
- Enforced changes to business
- Expensive and time-consuming use of third party or skilled persons
- Inability to recruit and retain high quality skilled resources

REGULATORY
- Greater regulatory scrutiny
- More regulation, cost and complexity for all

ILLUSTRATIVE TABLE SHOWING POSSIBLE RISKS OF NON – COMPLIANCE (Area wise)

Compliance area (illustrative)	Possible risk of Non-compliance
Direct tax compliance	• Imposition of penalty Prosecution of directors • Loss of reputation
Indirect tax compliance	• Cancellation of licences Withdrawal of tax benefits Stoppage of operations • Loss of reputation
Labour law compliance	• Imposition of penalty • Prosecution of directors / occupier Loss of reputation • Employee dissatisfaction
Environment, health & safety laws	• Stoppage of operations • Loss of reputation • Imposition of penalty
Corporate law compliance	• Imposition of penalty • Vacation / prosecution of directors or management • Loss of reputation

COMPLIANCE RISK MANAGEMENT

Compliance risk management is the process of managing corporate compliance to meet regulations within a workable timeframe and budget. Compliance Risk management is part of the collective governance, risk management and compliance discipline. The three fields frequently overlap in the areas of incident management, internal auditing, operational risk assessment, and compliance with various regulations.

In recent years, perception of compliance has undergone a sea change. The traditional and narrow outlook that compliance is limited to statutory filings, required to run a business, has widened considerably. Compliance practices are now a cross-functional responsibility. They need to be integrated in the policies and procedures of various functions like HR, quality, risk, facilities, finance, delivery, sales, marketing, procurement, security and more.

Further, laws and regulations in different countries at the national, state and local levels have made compliance more complicated. Therefore, a culture must be instilled in an enterprise to ensure minimum statutory compliance and compliance to other commitments such as social, industry, client consumer etc. This calls for a systematic approach towards compliance management.

As compliance risk continues to be a focal point for regulators, compliance officers are encouraged to take steps to ensure that compliance risk is adequately managed. Best practices for compliance management ensure that compliance risk is adequately managed. On a periodic basis, management should identify and assess the primary compliance risk issues applicable to all business activities including the related control mechanisms utilized to identify measure, monitor and control the relevant risks as ccompliance challenges will only increase with time.

STEPS IN COMPLIANCE RISK MANAGEMENT

1. Understand compliance obligations : The primary element to manage compliance is to understand compliance obligation in the light of strategic goals and objectives. Compliance obligations stem from: Laws and regulations, industry or generic standards, internal policies, processes and procedures and contracts executed with clients and other stakeholders.

It is important to understand that obligations are either requirements or commitments. Obligations that an enterprise has no control over are termed as compliance requirements, for example, one resulting from new laws and regulations. While obligations that an enterprise may choose to abide by – for example certain industry standards or best practices – are termed as compliance commitments.

Here, a mechanism to ensure compliance obligations are kept up-to-date must be established. An enterprise may choose to restrict the scope of compliance management to compliance requirement but for a higher assurance, it may include compliance commitments, too.

2. Assess risks : Once compliance obligations are established, a compliance risk assessment exercise

should be undertaken to identify risks, causes, the areas they impact and the consequences thereof. A risk analysis to have better understanding of the risks should follow. Such an analysis should consider the factors affecting the consequences and likelihood of these consequences occurring as well as the controls in place. Looking at the level of risk arrived at from the analysis exercise, a compliance risk evaluation should be done to take appropriate decisions on treatment. This exercise is to prioritise the treatment, it should be used as a tool to accept compliance risks. Compliance risks analysed as low should also be monitored and subjected to corrective action.

3. Address all compliance risks : An enterprise should ensure an effective action plan to address all compliance risks with clear ownership, responsibility, accountability and closure timelines. This can be driven with ease, if the enterprise ensures a documented compliance policy, objectives, processes and procedures. Further, compliance responsibilities must be clearly identified, assigned and established as part of the job descriptions at different levels.

To ensure risks are addressed effectively, the management should ensure that all employees with compliance obligation are competent. Periodic training and awareness must be carried out and any other medium to communicate assigned responsibilities should be explored. A continuous communication mechanism is required to ensure all employees understand compliance and contribute to it by reporting risks and discharging their responsibilities effectively.

4. Evaluate performance : A mechanism to measure and monitor the performance of the compliance practices and its impact on strategic goals and objectives must be developed. Developing compliance performance indicators is one of the tools. It can be as simple as the number of employees trained on compliance practices to mature indicators such as risks of non-compliance and trends. Feedbacks from clients, stakeholders, suppliers, vendors, employees and government agencies are a good source of data to ascertain compliance performance. Governance mechanisms in the form of management reviews, internal audits and periodic compliance reporting give great insights on the performance of compliance practices.

COMPLIANCE RISK MITIGATION

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. 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/ o rlitigation?
- 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. ● Compile and maintain a legislative universe for the organisation. ● Facilitate the risk prioritisation of all pieces of legislation in the regulatory universe. ● Initiate new legislative requirements within the organisation.

	● 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") ● 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.

ESSENTIALS OF A SUCCESSFUL COMPLIANCE-RISK MANAGEMENT PROGRAM

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.

NEW DEVELOPMENTS- GOVERNANCE AND RISK COMPLIANCE (GRC)

Until fairly recently, compliance was seen as a separate business practice, along with governance and risk management. However, over the past decade, these three disciplines have developed a considerable number of overlapping activities, such as internal audits, incident management, operational risk assessment, or compliance with regulatory programs. Today, many companies take an integrated approach to these three areas, referring to them collectively as Governance, Risk Management and Compliance (GRC).

GRC is the integrated collection of capabilities that enable an organization to reliably achieve objectives, address

uncertainty and act with integrity. Governance, risk and compliance (GRC) refers to a strategy for managing an organization's overall governance, enterprise risk management and compliance with regulations. GRC is a set of processes and practices that runs across departments and functions. GRC might be enabled by a dedicated platform and other tools, although this is not mandatory. While organizations generally don't need to maintain a separate GRC department, most organizations have a team in place to manage the GRC platform and tools. The scope of GRC doesn't end with just governance, risk, and compliance management, but also includes assurance and performance management, information security management, quality management, ethics and values management, and business continuity management.

Effective GRC implementation helps the organization to reduce risk and improve control effectiveness, security and compliance through an integrated and unified approach that reduces the ill effects of organizational silos and redundancies.

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

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: Its 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

- 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 risk. State briefly the need of compliance risk management in the emerging scenario.
2. Explain the consequences/ risks of non-compliance.
3. What are the steps in effective compliance risk management?
4. Write a short note on essentials of a successful compliance-risk management program.

Lesson 11
Corporate Governance Forums

LESSON OUTLINE

- Introduction
- The Institute of Company Secretaries of India
- National Foundation for Corporate Governance
- Organisation for Economic Cooperation 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

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 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.
- **Customied 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.

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 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.

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.

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. 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 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.

Objects of IOD
(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;
(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;
(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
(d) to advance the interests of members of the Institute, and to provide facilities, services and benefits for them.

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.

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.

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 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 helps 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

– http://www.ecgi.org/codes/code.php?code_id=24

Lesson 12
Risk Management

LESSON OUTLINE

- Risk
- Classification of Risks
- Risk Management
- Advantages of Risk Management
- Steps in Risk Management Process
  - Risk Identification
  - Risk Analysis
  - Risk Assessment
  - Handling of Risk
- Risk Mitigation Strategy
- Maintaining the Risk Strategy
- Fraud Risk Management
- Reputation Risk Management
- Responsibility of Risk Management
- Role of Company Secretary in Risk Management
- Risk Governance
- Risk Management Frameworks And Standards
  - Enterprise Risk Management – Integrated Framework (2004)
  - ISO 31000: International Standard For Risk Management
- Risk Management and Internal Controls
- Risk Matrix
- Model Risk Management Policy
- 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.

"Today's fast-paced business environment encounters a complex and ever-changing risk landscape that may negatively impact the organizational value. The only way to respond to it is by having a dynamic and holistic perspective of risk management approach to ensure business continuity."

– Jack Zahran, President, Pinkerton

RISK

Managing risk has become a critical element within most companies. The management of risk, though, can be structured differently within companies even for those within the same sector. So what is risk? In the business world, the word risk has come to mean an impediment to the achievement of an organization's objectives. As per the Oxford Dictionary- "Risk is Exposure to the possibility of loss, injury, or other adverse or unwelcome circumstance; a chance or situation involving such a possibility'.

While some risk is inherent in every business, organisations and entrepreneurship need to be willing to take risks as without risk there can be no meaningful gain. Like stress one has to live with risk and it cannot be avoided. At best risk can be managed or mitigated. This does not imply taking risk for the sake of taking it rather at every step the risk need to be understood and managed to realize the ultimate gains. However, the cost of risk management failures is still often underestimated, both externally and internally, including the cost in terms of management time needed to rectify a situation where the risks were not understood and managed well. It may be appropriate to say that without "risk management" there is no sustainable gain possible.

Well governed firms ensure that risks are understood, managed, and appropriately communicated and shared. Organizations that manage risks effectively are more likely to protect themselves and succeed in growing their business on a sustainable and long term basis. The challenge in achieving a strong risk management culture for any business is that risk management does not remain outside the mainstream rather that it is fully integrated as good and necessary practice into the day-to-day and every operation and function and therefore covers the organizational practices comprehensively and intrinsically.

CLASSIFICATION OF RISKS

Risk may be classified according to controllability, i.e Controllable risk and Uncontrollable risk. In other words, the Controllable risk is categorized as Unsystemic Risk and Uncontrollable risk is categorized as Systemic Risk. The concept of controllable and uncontrollable risk may be further explained as under:

Systemic Risk	Unsystemic Risk
● It is not fully uncontrollable by an organisation. ● It is not entirely predictable. ● It is usually of a macro nature. ● It usually affects a large number of organisations operating under a similar stream. ● It cannot be fully assessed and anticipated in advance in terms of timing and gravity. ● The example of such type of risks is Interest Rate Risk, Market Risk, Purchasing Power Risk.	● It is usually controllable by an organisation. ● It is reasonably predictable. ● It is normally micro in nature. ● If not managed it directly affects the individual organisation first. ● It can be usually assessed well in advance with reasonable efforts and risk mitigation can be planned with proper understanding and risk assessment techniques. ● The examples of such risk are Compliance risk, Credit Risk, Operational Risk.

Types of Risks on the basis of impact on finance

The risks may also be broadly segregated as Financial Risk and Non-financial Risk. These are not necessarily mutually exclusive but it is good to understand the primary categorisation. Often both financial and non financial risks are present in any situations which need to be managed and understood.

Financial Risk	Non-Financial Risk
The risk which has some direct financial impact on the entity is treated as financial risk. This risk may be Market risk, Credit risk, Liquidity risk, Operational Risk, Legal Risk and Country Risk. The following chart depicts some of the various types of financial risks.	This type of risks do not usually have direct and immediate financial impact on the business, but the consequences are very serious and later do have significant financial impact if these risks are not controlled at the initial stage. This type of risk may include, Business/Industry & Service Risk, Strategic Risk, Compliance Risk, Industry Fraud Risk, Reputation Risk, Transaction risk, Disaster Risk.

Types of Financial Risks	
(i) 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 bench mark 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. For example 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 interest 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. For example in the context of securities, 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 change on account of the demand and supply factor.
(ii) 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 installments or due interest on the due date, is termed as credit risk.

(iii) Liquidity Risk	The liquidity risk arises due to mis-matches in the cash flow i.e. absence of adequate funds. 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 liquidity or enough products or securities etc to actually undertake buy and sell activities. e.g. in the context of securities trading 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 e.g. inability to manage funds by either borrowing or the sale of assets/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.
(iv) Operational / System/ Management Risk	It arises due to inadequate systems, system capacities, system failure, and 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.
(iv) Obsolescence Risk	In the rapid changing world Obsolescence risk is fast emerging and unless the companies are able to cope up with this timely, the impact will be quite heavy and may lead to closure of the units also. Nokia is the latest example on this.
(v) 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, defaults and mismanagement of legal affairs etc.
(vi) Political/ Country Risk	Political risk may be on account of declaration of elections in the territory, area specific risk and political uncertainity. 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. These can also be existing risks due a country's legal or political structure which drives other institutions like judiciary, legislative and general environment for business.

Types of Non Financial Risks	
(i) 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.

(ii) Strategic Risk	Business plans which have not been developed properly and comprehensively since 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.
(iii) Compliance Risk	This risk arises on account of non-compliance or breaches of laws/ regulations which the entity is supposed to adhere. It may result in deterioration of reputation in public eye, penalty and penal provisions.
(iv) Fraud Risk	Fraud is perpetrated through the abuse of systems, controls, procedures and working practices. It may be perpetrated by an outsider or insider. Fraud may not be usually detected immediately and thus the detection should be planned for on a proactive basis rather than on a reactive basis.
(v) Reputation Risk	This type of risk arises from the negative public opinion. Such type of risk may arise from e.g. from the failure to assess and control compliance risk and can result in harm to existing or potential business relationships.
(vi) Transaction Risk	Transaction risk arises due to the failure or inadequacy of internal system, information channels, employees integrity or operating processes.
(vii) 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.
(viii) Regulatory Risk	On account of change in Government policies and perceptions. Especially this type of risks is associated with Food and beverages and Pharmaceuticals industries.
(ix) Technology Risk	Failure of system caused due to tampering of data access to critical information, non availability of data and lack of controls.

RISK MANAGEMENT

Different types of risk existing in the business are to be controlled, mitigated and managed. Risk management has become the mechanism to manage risks so that the negative consequences are kept within acceptable tolerances.

"Risk Management" is a term used to describe the processes which aim to assist organisations identify, understand, evaluate and take action on their risks with a view to increasing the probability of their success and reducing the impact and likelihood of failure. Effective risk management gives comfort to shareholders, customers, employees, other stakeholders and society at large that a business is being effectively managed and also helps the company or organisation confirm its compliance with corporate governance requirements.

Risk management is relevant to all organisations large or small. Effective risk management practices support accountability, performance measurement and reward and can enable efficiency at all levels through the organisation. Risk management requires a detailed knowledge and understanding of the organization (both internal and external) and the processes involved in the business.

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.

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 a 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:

- Ensure that all the foreseeable risks involved are actually understood and accepted before important decisions are taken.
- 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.

ADVANTAGES OF RISK MANAGEMENT

Risk management plays vital role in strategic planning. It is an integral part of project management. An effective risk management plan focuses on identifying and assessing possible risks.

Some of the key advantages of having risk management are as under:

- Risk Management in the long run always results in significant cost savings and prevents wastage of time and effort in firefighting. It develops 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 stake holders leading to an enhanced reputation.
- Sound Risk Management practices reassure key stakeholders throughout the organization.

STEPS IN RISK MANAGEMENT PROCESS

The process of risk management consists of the following logical and sequential steps:

I. RISK IDENTIFICATION

Risk identification is the first stage of the risk management strategy. The origin/source of the risk is identified. For example a risk may be due to transport of hazardous raw material to the factory. So the source of the risk origin is utmost important and from this point the journey start to manage the risks.

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.

Objective : The objective of the risk identification process is to ensure that all potential project risks are identified. 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.

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.

II. 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.

Risk analysis is useful in many situations like:

- 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.

Process of Risk Analysis

a) **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.

b) **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:

Risk Value = Probability of Event × Cost of Even

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 (Probability of Event) x Rs.500, 000 (Cost of Event) = Rs. 400,000 (Risk Value)

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.

III. RISK ASSESSMENT

Risk assessment is the way in which enterprises get a handle on how significant each risk is to the achievement of their overall goals. To accomplish this, enterprises require a risk assessment process that is practical, sustainable, and easy to understand. The process must proceed in a structured and disciplined fashion. It must be correctly sized to the enterprise's size, complexity, and geographic reach.

When assessing risks, it's important to determine whether the risk is - inherent risk, residual risk, or both. Inherent risk as the risk to an entity in the absence of any actions management might take to alter either the risk's likelihood or impact. Residual risk is the risk remaining after management's response to the risk. Some entities interpret:

- inherent risk to be level of risk assuming responses currently in place fail,and
- residual risk to be the level of risk assuming existing responses operate according to design.

Some other entities interpret inherent risk to be the current level of risk assuming existing responses operate according to design and residual to be the estimated risk after responses under consideration are put into place. The first approach is focused more on controls effectiveness of the current environment and the second approach on evaluating risk response options. There is no one right answer and either approach may be useful depending upon the purpose of the assessment and the nature of the risks being considered.

Process of Risk Analysis

1) **Develop assessment criteria**: The first activity within the risk assessment process is to develop a common set of assessment criteria to be deployed across business units, corporate functions, and large capital projects. Risks and opportunities are typically assessed in terms of impact and likelihood. Many enterprises recognize the utility of evaluating risk along additional dimensions such as vulnerability and

speed of onset.

2) **Assess risks**: Assessing risks consists of assigning values to each risk and opportunity using the defined criteria. An initial screening of the risks and opportunities is performed using qualitative techniques followed by a more quantitative treatment of the most important risks and opportunities lending themselves to quantification (not all risks are meaningfully quantifiable). Qualitative assessment consists of assessing each risk and opportunity according to descriptive scales as described in the previous section. Quantitative analysis requires numerical values for both impact and likelihood using data from a variety of sources.

   The quality of the analysis depends on the accuracy and completeness of the numerical values and the validity of the models used. Model assumptions and uncertainty should be clearly communicated and evaluated using techniques such as sensitivity analysis. Both qualitative and quantitative techniques have advantages and disadvantages. Most enterprises begin with qualitative assessments and develop quantitative capabilities over time as their decision-making needs dictate.

   For qualitative assessments, the most commonly used assessment techniques are interviews, cross-functional workshops, surveys, benchmarking, and scenario analysis. Quantitative techniques range from benchmarking and scenario analysis to generating forward looking point estimates (deterministic models) and then to generating forward looking distributions (probabilistic models). Some of the most powerful probabilistic models from an enterprise-wide standpoint include causal at-risk models used to estimate gross profit margins, cash flows, or earnings over a given time horizon at given confidence levels.

3) **Assess risk interactions**: Risks do not exist in isolation. Enterprises have come to recognize the importance of managing risk interactions. Even seemingly insignificant risks on their own have the potential, as they interact with other events and conditions, to cause great damage or create significant opportunity. Therefore, enterprises are gravitating toward an integrated or holistic view of risks using techniques such as risk interaction matrices, bow-tie diagrams, and aggregated probability distributions.

4) **Prioritize risks**: Once the risks have been assessed and their interactions documented, it's time to view the risks as a comprehensive portfolio to enable the next step – prioritizing for risk response and reporting to different stakeholders. Risk prioritization is the process of determining risk management priorities by comparing the level of risk against predetermined target risk levels and tolerance thresholds. While each risk captured may be important to management at the function and business unit level, the prioritization helps provide focus to senior management and board in addressing and giving attention to key risks. Ranking and prioritizing is often done in a two-step process.

   - First, the risks are ranked according to one, two, or more criteria such as impact rating multiplied by likelihood rating or impact multiplied by vulnerability.
   - Second, the ranked risk order is reviewed in light of additional considerations such as impact alone, speed of onset, or the size of the gap between current and desired risk level (risk tolerance threshold). If the initial ranking is done by multiplying financial loss by likelihood, then the final prioritization should take qualitative factors into consideration.

5) **Response to Risks**: The results of the risk assessment process then serve as the primary input to risk responses whereby response options are examined (accept, reduce, share, or avoid), cost-benefit analyses performed, a response strategy formulated, and risk response plans developed.

6) **Effective and sustainable risk assessment process**: To be effective and sustainable, the risk assessment process needs to be simple, practical, and easy to understand. People aren't enough. To be efficient, they must be supported by the right technology.

IV. HANDLING OF RISK

The ownership of risk should be allocated. Responsibilities and accountabilities of the persons handling risks need to be identified and assigned. The persons concerned when the risk arises, should document it and report it to the higher ups in order to have the early measures to get it minimized. Risk may be handled in the following ways:

1) **Risk Avoidance**: Risk Avoidance means to avoid taking or choosing of less risky business/project. For example one may avoid investing in stock market due to price volatility in stock prices and may prefer to invest in debt instruments.

2) **Risk Retention/absorption**: It is the handling the unavoidable risk internally and the firm bears/ absorbs it due to the fact that either because insurance cannot be purchased of such type of risk or it may be of too expensive to cover the risk and much more cost-effective to handle the risk internally. Usually, retained risks occur with greater frequency, but have a lower severity. An insurance deductible is a common example of risk retention to save money, since a deductible is a limited risk that can save money on insurance premiums for larger. There are two types of retention methods for containing losses as under:

   – Active Risk Retention: Where the risk is retained as part of deliberate management strategy after conscious evaluation of possible losses and causes.

   – Passive Risk Retention: Where risk retention occurred through negligence. Such type of retaining risk is unknown or because the risk taker either does not know the risk or considers it a lesser risk than it actually is.

3) **Risk Reduction**: In many ways physical risk reduction (or loss prevention, as it is often called) is the best way of dealing with any risk situation and usually it is possible to take steps to reduce the probability of loss. The ideal time to think of risk reduction measures is at the planning stage of any new project when considerable improvement can be achieved at little or no extra cost. The cautionary note regarding risk reduction is that, as far as possible expenditure should be related to potential future savings in losses and other risk costs; in other words, risk prevention generally should be evaluated in the same way as other investment projects.

4) **Risk Transfer**: This refers to legal assignment of cost of certain potential losses to another. The insurance of 'risks' is to occupy an important place, as it deals with those risks that could be transferred to an organization that specialises in accepting them, at a price. Usually, there are 3 major means of loss transfer viz.,

   - By Tort,
   - By contract other than insurance,
   - By contract of insurance.

   The main method of risk transfer is insurance. The value of the insurance lies in the financial security that a firm can obtain by transferring to an insurer, in return for a premium for the risk of losses arising from the occurrence of a specified peril. Thus, insurance substitutes certainty for uncertainty. Insurance does not protect a firm against all perils but it offers restoration, atleast in part of any resultant economic loss.

RISK MITIGATION STRATEGY

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. The risk mitigation step involves development of mitigation plans designed to manage, eliminate, or reduce risk to an acceptable level. 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 aeroplaneswere 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.

FRAUD 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. Explantion 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 should 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.

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.

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 like:

- 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.
- Regulation 21 of SEBI (LODR) Regulations, 2015, requires that every listed company should have a Risk Management Committee (details are provided undr the chapter of Board Committees)

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.
- 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.

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 pay 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

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.

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 organisation and its functionaries in its day to day functioning.

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.

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, atleast once in 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 that 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.

RISK MANAGEMENT FRAMEWORKS AND STANDARDS

Many standards and guidelines have been developed worldwide to help organisations implement risk management systematically and effectively. These standards seek to establish a common view on frameworks, processes and practice, and are generally set by recognised international standards bodies or by industry groups. Risk management is a fast-moving discipline and standards are regularly supplemented and updated.

The different standards reflect the different motivations and technical focus of their developers, and are appropriate for different organisations and situations. Standards are normally voluntary, although adherence to a standard may be required by regulators or by contract.

1) Enterprise Risk Management – Integrated Framework (2004)

In response to a need for principles-based guidance to help entities design and implement effective enterprise-wide approaches to risk management, Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued the Enterprise Risk Management – Integrated Framework in 2004. This framework defines essential enterprise risk management components, discusses key ERM principles and concepts, suggests a common ERM language, and provides clear direction and guidance for enterprise risk management. The guidance introduces an enterprise-wide approach to risk management as well as concepts such as: risk appetite, risk tolerance, portfolio view. This framework is now being used by organizations around the world to design and implement effective ERM processes.

The Enterprise Risk Management – Integrated Framework which is one of the most widely recognized and applied enterprise risk management frameworks in the world. It provides a principles-based approach to help organizations design and implement enterprise-wide approaches to risk management.

Enterprise risk management deals with risks and opportunities affecting value creation or preservation, defined as follows:

Enterprise risk management is a process, effected by an entity's board of directors, management and other

personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.

This definition is purposefully broad. It captures key concepts fundamental to how companies and other organizations manage risk, providing a basis for application across organizations, industries, and sectors. It focuses directly on achievement of objectives established by a particular entity and provides a basis for defining enterprise risk management effectiveness.

Value is maximized when management sets strategy and objectives to strike an optimal balance between growth and return goals and related risks, and efficiently and effectively deploys resources in pursuit of the entity's objectives.

Enterprise risk management encompasses:

- *Aligning risk appetite and strategy* – Management considers the entity's risk appetite in evaluating strategic alternatives, setting related objectives, and developing mechanisms to manage related risks.
- *Enhancing risk response decisions* – Enterprise risk management provides the rigor to identify and select among alternative risk responses – risk avoidance, reduction, sharing, and acceptance.
- *Reducing operational surprises and losses* – Entities gain enhanced capability to identify potential events and establish responses, reducing surprises and associated costs or losses.
- *Identifying and managing multiple and cross-enterprise risks* – Every enterprise faces a myriad of risks affecting different parts of the organization, and enterprise risk management facilitates effective response to the interrelated impacts, and integrated responses to multiple risks.
- *Seizing opportunities* – By considering a full range of potential events, management is positioned to identify and proactively realize opportunities.
- *Improving deployment of capital* – Obtaining robust risk information allows management to effectively assess overall capital needs and enhance capital allocation.

Components of Enterprise Risk Management

Enterprise risk management consists of eight interrelated components. These are derived from the way management runs an enterprise and are integrated with the management process. These components are:

- *Internal Environment* – The internal environment encompasses the tone of an organization, and sets the basis for how risk is viewed and addressed by an entity's people, including risk management philosophy and risk appetite, integrity and ethical values, and the environment in which they operate.
- *Objective Setting* – Objectives must exist before management can identify potential events affecting their achievement. Enterprise risk management ensures that management has in place a process to set objectives and that the chosen objectives support and align with the entity's mission and are consistent with its risk appetite.
- *Event Identification* – Internal and external events affecting achievement of an entity's objectives must be identified, distinguishing between risks and opportunities.

Opportunities are channeled back to management's strategy or objective-setting processes.

- *Risk Assessment* – Risks are analyzed, considering likelihood and impact, as a basis for determining how they should be managed. Risks are assessed on an inherent and a residual basis.
- *Risk Response* – Management selects risk responses – avoiding, accepting, reducing, or sharing risk – developing a set of actions to align risks with the entity's risk tolerances and risk appetite.

- *Control Activities* – Policies and procedures are established and implemented to help ensure the risk responses are effectively carried out.
- *Information and Communication* – Relevant information is identified, captured, and communicated in a form and timeframe that enable people to carry out their responsibilities. Effective communication also occurs in a broader sense, flowing down, across, and up the entity.
- *Monitoring* – The entirety of enterprise risk management is monitored and modifications made as necessary. Monitoring is accomplished through ongoing management activities, separate evaluations, or both.

Enterprise risk management is not strictly a serial process, where one component affects only the next. It is a multidirectional, iterative process in which almost any component can and does influence another.

Limitations

While enterprise risk management provides important benefits, limitations exist. In addition to factors discussed above, limitations result from the realities that human judgment in decision making can be faulty, decisions on responding to risk and establishing controls need to consider the relative costs and benefits, breakdowns can occur because of human failures such as simple errors or mistakes, controls can be circumvented by collusion of two or more people, and management has the ability to override enterprise risk management decisions.

These limitations preclude a board and management from having absolute assurance as to achievement of the entity's objectives.

Roles and Responsibilities

Everyone in an entity has some responsibility for enterprise risk management. The chief executive officer is ultimately responsible and should assume ownership. Other managers support the entity's risk management philosophy, promote compliance with its risk appetite, and manage risks within their spheres of responsibility consistent with risk tolerances. A risk officer, financial officer, internal auditor, and others usually have key support responsibilities.

Other entity personnel are responsible for executing enterprise risk management in accordance with established directives and protocols. The board of directors provides important oversight to enterprise risk management, and is aware of and concurs with the entity's risk appetite. A number of external parties, such as customers, vendors, business partners, external auditors, regulators, and financial analysts often provide information useful in effecting enterprise risk management, but they are not responsible for the effectiveness of, nor are they a part of, the entity's enterprise risk management.

2. ISO 31000: International Standard for Risk Management

ISO 31000 is the international standard for risk management. This standard is published on the 13th of November 2009. By providing comprehensive principles and guidelines, this standard helps organizations with their risk analysis and risk assessments. ISO 31000 applies to most business activities including planning, management operations and communication processes. Whilst all organizations manage risk to some extent, this international standard's best-practice recommendations were developed to improve management techniques and ensure safety and security in the workplace at all times.

By implementing the principles and guidelines of ISO 31000 in organization, the organisation is able to improve operational efficiency, governance and stakeholder confidence, while minimising losses. This international standard also helps to boost health and safety performance, establish a strong foundation for decision making and encourage proactive management in all areas.

Scope

ISO 31000:2009 provides generic guidelines for the design, implementation and maintenance of risk management processes throughout an organization. This approach to formalizing risk management practices will facilitate broader adoption by companies who require an enterprise risk management standard that accommodates multiple 'silo-centric' management systems.

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.

Accordingly, ISO 31000:2009 is intended for a broad stakeholder group including:

- executive level stakeholders
- appointment holders in the enterprise risk management group
- risk analysts and management officers
- line managers and project managers
- compliance and internal auditors
- independent practitioners.

Benefits of ISO 31000

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.
- Proactively improve operational efficiency and governance

Managing risk

ISO 31000:2009 gives a list on how to deal with risk:

1. Avoiding the risk by deciding not to start or continue with the activity that gives rise to the risk
2. Accepting or increasing the risk in order to pursue an opportunity
3. Removing the risk source
4. Changing the likelihood
5. Changing the consequences
6. Sharing the risk with another party or parties (including contracts and risk financing)
7. Retaining the risk by informed decision

RISK MANAGEMENT AND INTERNAL CONTROLS

Risk management focuses on identifying threats and opportunities, while internal control helps counter threats and take advantage of opportunities. Proper risk management and internal control assist organizations in making informed decisions about the level of risk that they want to take and implementing the necessary controls to effectively pursue their objectives.

Successful organizations integrate effective governance structures and processes with performance-focused risk management and internal control at every level of an organization and across all operations.

The risk profile of a company may be represented through a Risk Register, a suggestive template of which is illustrated below:

Sl.No	Risk Area	Key risks	Root cause	Mitigation measures
1.	Business Risk	Decreasing market share	Lack of innovation, market survey etc.,	Keeping a vigil on latest developments and continuous monitoring
2.	Financial risk	Leveraging capital structure and the cash flows	Inability to assess the appropriate funding requirements	Adoptiong a Resource planning policy
3.	Regulatory and Compliance Risk	Non compliance of applicable laws	Not keeping abreast of the latest changes in the Regulatory environment	knowledge updation & maintenance of a robust compliance check list

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..

– **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

(*These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation*)

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:
   a) ISO 31000:2009 relating to the Risk Management.
   b) Fraud Risk Management.
   c) Reputation Risk Management.
   d) Reporting of fraud by Statutory Auditor.

Lesson 13
Compliance Management

LESSON OUTLINE

- Introduction
- Compliance
- Significance of Compliance
- Different aspects of Compliances
- Corporate Compliance Management
- Significance of Corporate Compliance Management
- Essentials of an Effective Compliance Program
- Challenges for Effective Corporate Compliance Management
- Scope of Corporate Compliance Management
- Process of Corporate Compliance Management
- Checklist to be followed for setting up a Good Compliance Program
- Internal Compliance Reporting Mechanism (ICRM)
- Use of Technology for Compliance Management
- Compliance Solutions
- Compliance with Spirit of Law (Ethics)
- Role of Company Secretaries
- 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.

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.

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.

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.

SIGNIFICANCE OF COMPLIANCE

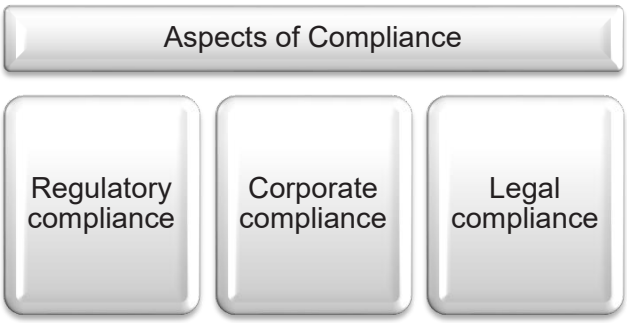
Corporate accountability is on everyone's mind today. Business executive faces significant pressure to comply with a steady stream of complex regulations. Many companies are adopting comprehensive compliance plans

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

DIFFERENT ASPECTS OF COMPLIANCES



A. 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.

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.

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. 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

SIGNIFICANCE OF CORPORATE COMPLIANCE MANAGEMENT

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. The following points clarify 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

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:

(i) **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. 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.

(ii) **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.

(iii) **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.

(iv) **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.

(v) **Internal monitoring and auditing**: The compliance policy shall contain a clause for having the effective auditing and monitoring plans.

(vi) **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.

(vii) **Enforcement of disciplinary standards**: There shall be a clause in the compliance policy to take the disciplinary action against the erring official, who has not adhered to the prescribed set of rules and regulations.

(viii) **Effective use of Information technology**: By using available tools of information technology compliances can be managed effectively. Various compliance management software are available to facilitate compliance management.

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.

PROCESS OF CORPORATE COMPLIANCE MANAGEMENT

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.

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.

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.

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-

(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.
- Emblems and Names (Prevention of Improper Use) Act, 1947.
- Foreign Exchange Management Act, 1999 and the various Notifications, Rules and Regulations framed there under.
- Foreign Contribution Regulation Act, 1976.
- Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974.
- Competition Law.
- Special Economic Zones Act, 2005.
- Prevention of Money Laundering Act, 2002.
- Micro, Small and Medium Enterprises Development Act, 2006.
- Essential Commodities Act, 1955.
- Intellectual Property Laws.

(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
- Contract Labour (Regulation and Abolition) Act, 1970.

(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
- Public Liability Insurance Act, 1991.

(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.

USE OF TECHNOLOGY FOR COMPLIANCE MANAGEMENT

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.

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'. Compliance solution providers adopts 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 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 grass roots 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 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 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 behaviours.

- **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 organisations 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.

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

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.

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.

Also as per section 204(1) of Companies Act, 2013 read with rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, Company Secretary in Practice is the secretarial auditor. 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 hereunder;

(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 client;

(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;

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.

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.

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

(*These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation*)

1. Draft a Compliance Management programme for a listed company.
2. Describe the scope of compliance management.
3. Explain compliance management process in general.
4. Explain the systems approach to compliance management.

Lesson 14
Internal Control

LESSON OUTLINE

- Introduction
- Nature of Internal Control
- Classification of Internal Control
- Elements of Internal Control
- Components of Internal Control
- Limitations of Internal Control
- Techniques of Internal Control System
- Steps for Internal Control
- COSO's Internal Control Framework
- Role 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.

"Information is a significant component of most organizations' competitive strategy either by the direct collection, management, and interpretation of business information or the retention of information for day-to-day business processing. Some of the more obvious results of IS failures include reputational damage, placing the organization at a competitive disadvantage, and contractual noncompliance. These impacts should not be underestimated."

– The IIA Research Foundation

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 set 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

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.

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.

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 trust worthy. 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 out 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.

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.

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).

COSOs Internal Control - Integrated Framework

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.
- 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
   3. instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company's internal control system over financial reporting.

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 as 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.

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 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 in-built systems of independent checking of the work done by other. 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

(*These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation*)

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.

Lesson 15
Reporting

LESSON OUTLINE

- Introduction
- Financial Reporting
- Objectives of Financial Reporting
- Importance of Financial Reporting
- Limitations of Financial Reporting
- Non-Financial Reporting
- Board's Report
- Corporate Social Responsibility Report
- Corporate Sustainability Reporting
- Benefits of Sustainability Reporting
- GRI - Sustainability Reporting Framework
- Sustainability Reporting Framework in India
- Challenges in Mainstreaming Sustainability Reporting
- Towards Integrated Reporting
- Integrated Reporting By Listed Entities in India
- Relation between Integrated Reporting and Sustainability Reporting
- Glossary
- LESSON ROUND-UP
- SELF TEST QUESTIONS

LEARNING OBJECTIVES

The future of corporate reporting is a subject attracting much attention of late. In this chapter we will discuss where corporate reporting stands at present and identify the key decisions that need to be taken to improve the quality and usefulness of reports with particular reference to non-financial reporting.

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. The legal provisions and regulations with regard to Board's Report, CSR Report and BRR reports have also been dealt.

This chapter explains the concepts of sustainability reporting and contemporary developments like integrated reporting.

"I think all good reporting is the same thing - the best attainable version of the truth."

– Carl Bernstein

INTRODUCTION

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. The annual report contains the financial reporting as well as non-financial reporting.

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 stock holder'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) has 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 male 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. In 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, bench marking 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.

Limitations of Financial 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 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 financial 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.

NON-FINANCIAL REPORTING

Apart from financial reporting, the non-financial reporting under the annual reports is 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 Stake holders by way of reporting in the annual report.

It is a structured way of presenting information about ones performance. Non financial reporting 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. Non financial reporting includes-

- Board's Report,
- Corporate Social Responsibility Report
- Corporate Sustainability Reporting

BOARD'S REPORT

The Companies Act, 2013, requires the Board of Directors of every company to attach its report to the financial statements to be laid before the members at the annual general meeting. The Board's Report is an important means of communication by the Board of Directors of a company with its stakeholders. The Board's Report provides the stakeholders with both financial and non-financial information, including the performance and prospects of the company, relevant changes in the management and capital structure, recommendations as to the distribution of profits, future and on-going programmes of expansion, modernisation and diversification, capitalisation of reserves, further issue of capital and other relevant information.

The Companies Act, 2013, mandates certain disclosures to be made in the Board's Report. A listed company is also required to comply with certain additional requirements as stated under the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Similarly, a company, whose securities are listed on an overseas stock exchange, is required to comply with additional requirements as may be specified by such stock exchange. Further, a company which is regulated under other laws, may also be required to make additional disclosures in its Board's Report as stated in the respective applicable laws.

The Board's Report should be based on the company's standalone financial statement and not on the consolidated financial statement and should relate to the financial year for which such financial statement is prepared. The Board's Report should avoid repetition of information. If any information is mentioned elsewhere in the financial statement, a reference thereof should be given in Board's Report instead of repeating the same.

A board's report should typically include information under following heads-

- Company Specific Information
- General Information

- Capital and Debt Structure
- Credit Rating of Securities
- Investor Education and Protection Fund (IEPF)
- Management
- Disclosures Relating to Subsidiaries, Associates and Joint Ventures
- Details of Deposits
- Particulars of Loans, Guarantees And Investments
- Particulars of Contracts or Arrangements with Related Parties
- Corporate Social Responsibility (CSR)
- Conservation of Energy, Technology Absorption,
- Foreign Exchange Earnings and Outgo
- Risk Management
- Details of Establishment of Vigil Mechanism
- Material Orders of Judicial Bodies /Regulators
- Auditors Report
- Secretarial Audit Report
- Explanations in Response to Auditors' Qualifications
- Compliance With Secretarial Standards
- Corporate Insolvency Resolution Process Initiated Under The Insolvency And Bankruptcy Code, 2016 (IBC)
- Failure to Implement any Corporate Action
- Annual Return
- Additional Disclosures Under Listing Regulations
- Disclosures Pertaining to the Sexual Harassment of Women at the Workplace (Prevention, Prohibition And Redressal) Act, 2013 etc.

CORPORATE SOCIAL RESPONSIBILITY REPORT

The Board of the Company is mandated to prepare a CSR Report under Section 134(3)(o) of the Companies Act, 2013. The Companies (CSR Policy) Rules, 2014 provide for the format for reporting CSR activities annually. The format for the annual report on CSR activities to be included in the Board's report is as follows:

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.
2. The Composition of the CSR Committee.
3. Average net profit of the company for the last three financial years
4. Prescribed CSR expenditure (two per cent, of the amount as in item 3 above
5. Details of CSR spent during the financial year

(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

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
S.No.	CSR project or activity identified	Sector in which the project is covered	Projects or programs (1) Local area or other (2) Specify the State and district where the project or programs was undertaken	Amount outlay (budget) project or program wise	Amount spent on the projects or programs Subheads: (1) Direct expenditure on projects or programs (2) Overheads	Cumulative expenditure upto the reporting period.	Amount spent directly or through implementation 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.

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.

CORPORATE 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.

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. 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.

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. It 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". 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. 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.

Sustainability Reporting Guidelines

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 in to a frame of reporting.

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 and Standard Disclosures

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.

There are two different types of Standard Disclosures:

1. GENERAL STANDARD DISCLOSURES

- Strategy and Analysis
- Organizational Profile
- Identified Material Aspects and Boundaries
- Stakeholder Engagement
- Report Profile
- Governance
- Ethics and Integrity

2. SPECIFIC STANDARD DISCLOSURES

- Disclosures on Management Approach
- Indicators

For detailed study students may refer- G4 Sustainability Reporting Guidelines available at https://www2.globalreporting.org/resourcelibrary/GRIG4-Part1-Reporting-Principles-and-Standard-Disclosures.pdf

SUSTAINABILITY REPORTING FRAMEWORK 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 a Environmental, Social and Governance ("ESG") perspective, SEBI decided to mandate inclusion of Business Responsibility Reports ("BRR reports") as part of the Annual Reports for listed entities.

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 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

S.No.	Particulars	Details
1	DIN Number if applicable	
2	Name	
3	Designation	
4	Telephone Number	
5	e-mail id	

(2) Principle-wise (as per NVGs) BR Policy/policies (Reply in Y/N)

S.No.	Questions	P1	P2	P3	P4	P5	P6	P7	P8	P9
1	Do you have a policy/policies for….									
2	Has the policy being formulated in consultation with the relevant stakeholders									
3	Does the policy conform to any national/ international standards. If yes, specify? (50 words)									
4	Has the policy being approved by the Board? If yes, has it been signed by MD/owner/ CEO/ Appropriate Board Directors									
5	Does the company have a specified committee of the Board/Official to oversee the implementation of the policy?									
6	Indicate the link for the policy to be viewed online?									
7	Has the policy been formally communicated to all relevant internal and external stakeholders?									
8	Does the company have in-house structure to implement the policy/policies?									
9	Does the company have grievance redressal mechanism related to the policy/policies to address stakeholders' grievances related to the policy/policies?									
10	Has the company carried out independent audit/evaluation of the working of this policy by an internal or external agency?									

(2a). If answer to S.No. 1 against any principle, id `No', please explain why; (Tick upto 2 options)

S.No.	Questions	P1	P2	P3	P4	P5	P6	P7	P8	P9
1	The company has not understood the Principles									
2	The company is not at a stage where it finds itself in a position to formulate and implement the policies on specified principles.									
3	The company does not have financial or manpower resources available for the task									
4	It is planned to be done within the next 6 months									
5	It is planned to be done within the next 1 year									
6	Any other reason (please specify)									

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

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.

SL. No.	Catagory	No. of complaints filed during the financial year	No. of complaints pending as on end of this the financial year
1.	Child labour/forced labour/ involuntary labour		
2.	Sexual harassment		
3.	Discriminatory employement		

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 web page 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?

National Guidelines on Responsible Business Conduct (NGRBC)

The Ministry of Corporate Affairs has revised the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, 2011 (NVGs) and has released the **National Guidelines on Responsible Business Conduct (NGRBC)** in March 2019. These guidelines urge businesses to actualise the principles in letter and spirit. This annexure 3 of the Guidelines details the reporting framework associated with the National Guidelines for Responsible Business Conduct.

It consists of three sections:

(a) Section A – General Disclosures, covering operational, financial and ownership related information,

(b) Section B – Management and Process Disclosures covering the structures, policies and processes to integrate the Guidelines, and

(c) Section C – Principle-wise Performance Indicators covering how well businesses are performing in pursuit of these Guidelines.

Businesses may use this reporting framework to voluntarily disclose their commitment to and performance against their economic, social and environmental impacts. A growing number of businesses are already doing this and are reporting several benefits, internal and external, as a result of their commitment to disclosure and reporting.

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 orgainsation 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.

TOWARDS 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 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.

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.

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.

International Integrated Reporting Framework (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.

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.

The **following Guiding Principles** underpin the preparation and presentation of an integrated report, informing the content of the report and how information is presented. 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.

Integrated Reporting by Listed Entities in India

SEBI vide its circular dated February 6, 2017 has stated that today an investor seeks both financial as well as non-financial information to take a well-informed investment decision. An integrated report aims to provide a concise communication about how an organisation's strategy, governance, performance and prospects create value over time. Further it may be noted that the concept of integrated reporting is being discussed at various international forums. The purpose of integrated reporting is to provide shareholders and interested stakeholders with relevant information that is useful for making investment decisions.

Also regulation 4(1)(d) of SEBI LODR states "the listed entity shall provide adequate and timely information to recognised stock exchange(s) and investors". IOSCO Principle 16 states "there should be full, accurate and timely disclosure of financial results, risks and other information that is material to investors´ decisions."

In this regard, the International Integrated Reporting Council ('IIRC') has prescribed Guiding Principles which underpin the preparation of an integrated report, specifying the content of the report and how information is to be presented. *(These principles have been discussed above).*

All organizations depend on various forms of capital for their success. It is important that all such forms of capital are disclosed to stakeholders to enable informed investment decision making. IIRC has categorized the forms of capital as follows:

- Financial capital
- Manufactured capital
- Intellectual capital
- Human capital
- Social and relationship capital

- Natural capital

The Integrated Reporting Framework prescribed by International Integrated Reporting Council ('IIRC') is available at web link: *http://integratedreporting.org/wp-content/uploads/2015/03/13-12-08-THEINTERNATIONAL-IR-FRAMEWORK-2-1.pdf 7.*

It has been observed that certain listed entities in India and other jurisdictions have already been making disclosures by following the principles of integrated reporting. Towards the objective of improving disclosure standards, in consultation with industry bodies and stock exchanges, the listed entities have been advised to adhere to the following by the SEBI vide this circular:

a. Integrated Reporting may be adopted on a voluntary basis from the financial year 2017-18 by top 500 companies which are required to prepare BRR.

b. The information related to Integrated Reporting may be provided in the annual report separately or by incorporating in Management Discussion & Analysis or by preparing a separate report (annual report prepared as per IR framework).

c. In case the company has already provided the relevant information in any other report prepared in accordance with national/international requirement / framework, it may provide appropriate reference to the same in its Integrated Report so as to avoid duplication of information.

d. As a green initiative, the companies may host the Integrated Report on their website and provide appropriate reference to the same in their Annual Report.

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

- Inegrated 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.

LESSON ROUND UP

- Financial reporting is the process of producing statements that disclose an organisation’s financial status to management, investors and the government.
- Non financial reporting 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.
- 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.
- 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.
- 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.
- 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 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.

SELF TEST QUESTIONS

(*These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation*)

1. What is Integrated Reporting?
2. Apart from the Financial Reporting, Non-financial reporting has become an integral part of the Annual Report. Please elucidate.
3. Discuss the limitations of financial reporting
4. What is a Sustainability Report?
5. Discuss the integrated reporting by listed entities in India.

Lesson 16
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

"I think all good reporting is the same thing - the best attainable version of the truth."

– Carl Bernstein

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:

1. Finance and Accounting: Creative accounting, Earnings management, Financial analysis, Insider trading, Securities Fraud, Facilitation payment.
2. Human Resource Management: Executive compensation, Affirmative action, Workplace surveillance, Whistle blowing, Occupational safety and health, Indentures servitude, Union busting, Sexual Harassment, Employee raiding.
3. Sales and Marketing: Price fixing, price discrimination, green washing, spamming, using addictive messages/images in advertising, Marketing to children, False advertising, Negative campaigning.

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: Harv 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."

Lets read one real life story narrated by Narayan Murthy in a recent interview:

In February 1984, Infosys decided to import a super minicomputer so that we could start developing software for overseas clients. When the machine landed at Bangalore Airport, the local customs official refused to clear it unless we "took care of him"—the Indian euphemism for demanding a bribe. A delay could have meant the end for us before we had even started. When an Infosys manager informed me about the problem, my only question was, "What is the alternative to paying a bribe?" The manager hesitantly replied that we could pay a customs duty of 135% and then appeal for a refund. I told him: "Do that."

We didn't have enough money to pay the duty and had to borrow it. However, because we had decided to do business ethically, we didn't have a choice. We would not pay bribes. We effectively paid twice for the machine and had only a slim chance of recovering our money. But a clear conscience is the softest pillow on which you can lay your head down at night.

However we must note here this link between higher ideals and the bottomline happens only when the pragmatic values like efficiency, productivity or prosperity, knowledge and competence, innovation, progress & perfection, quality etc. are not rejected or ignored but properly integrated with the pursuit and actualization of higher values.

In practical terms, it means the values and ideals of the higher mind and spirit should inspire, guide and control our physical and vital life and cast their refining influence on the body and life of our individual and collective organism.

The corporate world pursues mainly the economic bottomline. But this is not enough for success or even survival in the emerging world of the future. There are other imperatives or dimensions which need equal attention like the human, social, environmental and the evolutionary. So, we have suggested Five Bottom Lines of the future.

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

1. 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.

2. 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.

3. 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.

4. 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[1] (From Mahabharata)

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 leading Kauravites had fallen in Kurukshetra, and Ashwatthma 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. *Arjun*a 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.

1. Ref: Foundations of Managerial Work: Contributions from Indian Thought by S. K. Chakraborty

- 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[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 astir with this episode. It was a culture-shock for them because the recently-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[3]

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

2. Ref: Foundations of Managerial Work: Contributions from Indian Thought by S. K. Chakraborty, p.32,36
3. Leading with Wisdom by Peter Pruzen

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[4]

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 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

4. Leading with Wisdom by Peter Pruzen, p.244

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:

जानामि धर्मं न च मे प्रवृत्तिः
जानाम्यधर्मं न च मे निवृत्तिः ।
त्वया हृषीकेश हृदि स्थितेन
यथा नियुक्तोऽस्मि तथा करोमि ॥

Janaami dharmam na cha pravruthi,
Janamyadharmam na cha may nivruthi,
Kenapi devena hrudhi sthithena,

Yada niyuktho asmi karomi.

Pandavagita 57

I know what is right but I am not able to practice it;
I know what is wrong and I am not able to keep away from it.
I act as I am directed to by some mysterious power
that is seated in my heart.

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 in appropriate. 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 environment.

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.

Specific Professional Responsibilities

Live the Company's Values each day.

We must live the Company's Values each day. For quick reference our core values are:

Ownership

This is our company. We accept personal responsibility and accountability to meet business needs. Passion for winning

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.

People development

People are our most important asset. We add value through result driven training and we encourage and reward excellence.

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, 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 compete 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

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 ofIndian 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 17
CSR and Sustainability

LESSON OUTLINE

- Introduction
- Corporate Social Responsibility (CSR)
- Why CSR at All?
- Factors Influencing CSR
- Triple Bottom Line Approach of CSR
- Corporate Citizenship – Beyond The Mandate of Law
- Global Principles And Guidelines
- Corporate Sustainability
- United Nations Global Compact's Ten Principles, 2000
- CSR and Sustainability In India
- National Guidelines On Responsible Business Conduct (NGRBC) - 2019
- Sustainable Development
- The 2030 Agenda for Sustainable Development
- Sustainable Development Goals
- Sustainability Indices
- Measuring Business Sustainability
- 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

The 21st century is characterized by unprecedented challenges and opportunities, arising from globalization, the desire for inclusive development and the imperatives of climate change. Indian business, which is today viewed globally as a responsible component of the ascendancy of India, is poised now to take on a leadership role in the challenges of our times. It is recognized the world over that integrating social, environmental and ethical responsibilities into the governance of businesses ensures their long term success, competitiveness and sustainability. This approach also reaffirms the view that businesses are an integral part of society, and have a critical and active role to play in the sustenance and improvement of healthy ecosystems, in fostering social inclusiveness and equity, and in upholding the essentials of ethical practices and good governance. This also makes business sense as companies with effective CSR, have image of socially responsible companies, achieve sustainable growth in their operations in the long run and their products and services are preferred by the customers.

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.

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.

CORPORATE SOCIAL RESPONSIBILITY (CSR)

CSR is understood to be the way firms integrate social, environmental and economic concerns into their values, culture, decision making, strategy and operations in a transparent and accountable manner and thereby establish better practices within the firm, create wealth and improve society. CSR is also called Corporate Citizenship or Corporate Responsibility.

The 1950s saw the start of the modern era of CSR when it was more commonly known as Social Responsibility. In 1953, **Howard Bowen** published his book, ***"Social Responsibilities of the Businessman"***, and is largely credited with coining the phrase 'corporate social responsibility' and is perhaps the Father of modern CSR. Bowen asked: "what responsibilities to society can business people be reasonably expected to assume?" Bowen also provided a preliminary definition of CSR: "*its refers to the obligations of 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*".

According to Business for Social Responsibility (BSR) "Corporate social responsibility is operating a business in a manner which meets or excels the ethical, legal, commercial and public expectations that a society has from the business."

Business entity is expected to undertake those activities, which are essential for betterment of the society. Every aspect of business has a social dimension. Corporate Social Responsibility means open and transparent business practices that are based on ethical values and respect for employees, communities and the environment. It is designed to deliver sustainable value to society at large as well as to shareholders.

Corporate Social Responsibility is nothing but what an organisation does, to positively influence the society in which it exists. It could take the form of community relationship, volunteer assistance programmes, special scholarships, preservation of cultural heritage and beautification of cities. The philosophy is basically to return

to the society what it has taken from it, in the course of its quest for creation of wealth.

With the understanding that businesses play a key role of job and wealth creation in society, CSR is generally understood to be the way a company achieves a balance or integration of economic, environmental, and social imperatives while at the same time addressing shareholder and stakeholder expectations.

According to CSR Asia, a social enterprise, "CSR is a company's commitment to operate in an economically, socially and environmentally sustainable manner whilst balancing the interests of diverse stakeholders"

CSR is generally accepted as applying to firms wherever they operate in the domestic and global economy. The way businesses engage/involve the shareholders, employees, customers, suppliers, Governments, non-Governmental organizations, international organizations, and other stakeholders is usually a key feature of the concept. While an organisation's compliance with laws and regulations on social, environmental and economic objectives set the official level of CSR performance, it is often understood as involving the private sector commitments and activities that extend beyond this foundation of compliance with laws.

The term Corporate Social responsibility refers to the concept of business being accountable for how it manages the impact of its processes on stakeholders and takes responsibility for producing a positive effect on society.

According to the Commission of the European Communities, 2003, "CSR is the concept that an enterprise is accountable for its impact on all relevant stakeholders. It is the continuing commitment by business to behave fairly and responsibly and contribute to economic development while improving the quality of life of the work force and their families as well as of the local community and society at large."

According to the World Business Council for Sustainable Development, 1999 "Corporate Social Responsibility is the continuing commitment by business to behave ethically and contribute to the economic development while improving the quality of life of the workforce and their families as well as of the local community and the society at large."

CSR is a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis. The main function of an enterprise is to create value through producing goods and services that society demands, thereby generating profit for its owners and shareholders as well as welfare for society, particularly through an ongoing process of job creation. However, new social and market pressures are gradually leading to a change in the values and in the horizon of business activity.

Essentially, Corporate Social Responsibility is an inter-disciplinary subject in nature and encompasses in its fold:

1. Social, economic, ethical and moral responsibility of companies and managers,
2. Compliance with legal and voluntary requirements for business and professional practice,
3. Challenges posed by needs of the economy and socially disadvantaged groups, and
4. Management of corporate responsibility activities.

CSR is an important business strategy because, wherever possible, consumers want to buy products from companies they trust; suppliers want to form business partnerships with companies they can rely on; employees want to work for companies they respect; and NGOs, increasingly, want to work together with companies seeking feasible solutions and innovations in areas of common concern. CSR is a tool in the hands of corporates to enhance the market penetration of their products, enhance its relation with stakeholders. CSR activities carried out by the enterprises affects all the stakeholders, thus making good business sense, the reason being contribution to the bottom line.

WHY CSR AT ALL?

Business cannot exist in isolation; business cannot be oblivious to societal development. The social responsibility of business can be integrated into the business purpose so as to build a positive synergy between the two.

1. CSR creates a favourable public image, which attracts customers. Reputation or brand equity of the products of a company which understands and demonstrates its social responsibilities is very high. Customers trust the products of such a company and are willing to pay a premium on its products. Organizations that perform well with regard to CSR can build reputation, while those that perform poorly can damage brand and company value when exposed. Brand equity, is founded on values such as trust, credibility, reliability, quality and consistency.
2. Corporate Social Responsibility (CSR) activities have its advantages. It builds up a positive image encouraging social involvement of employees, which in turn develops a sense of loyalty towards the organization, helping in creating a dedicated workforce proud of its company. Employees like to contribute to the cause of creating a better society. Employees become champions of a company for which they are proud to work.
3. Society gains through better neighborhoods and employment opportunities, while the organisation benefits from a better community, which is the main source of its workforce and the consumer of its products.
4. Public needs have changed leading to changed expectations from consumers. The industry/ business owes its very existence society and has to respond to needs of the society.
5. The company's social involvement discourages excessive regulation or intervention from the Government or statutory bodies, and hence gives greater freedom and flexibility in decision-making.
6. The internal activities of the organisation have an impact on the external environment, since the society is an inter-dependent system.
7. A business organisation has a great deal of power and money, entrusted upon it by the society and should be accompanied by an equal amount of responsibility. In other words, there should be a balance between the authority and responsibility.
8. The good public image secured by one organisation by their social responsiveness encourages other organizations in the neighborhood or in the professional group to adapt themselves to achieve their social responsiveness.
9. The atmosphere of social responsiveness encourages co-operative attitude between groups of companies. One company can advise or solve social problems that other organizations could not solve.
10. Companies can better address the grievances of its employees and create employment opportunities for the unemployed.
11. A company with its "ear to the ground" through regular stakeholder dialogue is in a better position to anticipate and respond to regulatory, economic, social and environmental changes that may occur.
12. Financial institutions are increasingly incorporating social and environmental criteria into their assessment of projects. When making decisions about where to place their money, investors are looking for indicators of effective CSR management.
13. In a number of jurisdictions, governments have expedited approval processes for firms that have undertaken social and environmental activities beyond those required by regulation.

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.

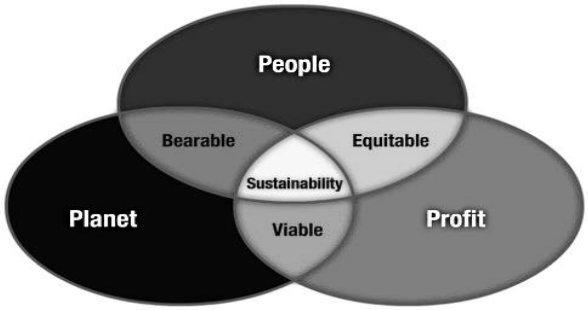
→ Citizens in many countries are making it clear that corporations should meet standards of social and environmental care, no matter where they operate.

→ 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.

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.

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.

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. As a good corporate citizen, the companies are required to focus on the following key aspects:

1. ***Absolute Value Creation for the Society****:* 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.

2. ***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.*

3. ***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.*

4. ***Equitable Business Practices****: Corporates should not indulge themselves in unfair means and should create candid business practices, ensuring healthy competition and fair trade practices.*

5. ***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.*

6. ***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.*

7. ***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.*

8. ***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.*

9. ***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*.

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)
- Tribal Cultural Society (TCS)
- Tata Steel Family Initiatives Foundation (TSFIF)
- Tata Steel Skill Development Society (TSSDS)
- Education
- Medical Services
- Urban Services
- Sports Department
- Tata Steel Adventure Foundation
- JUSCO
- Other societies like Ardeshir Dalal Memorial Hospital, Blood Banks, Kanti Lal Gandhi Memorial Hospital etc.)
- Tata Relief Committee

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.

- **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.

CORPORATE SUSTAINABILITY

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 survivial 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 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." Paul Hawkin's book – The Ecology of Commerce

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.

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.

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.

Joining the Global Compact is a widely visible as 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.

CSR AND SUSTAINABILITY IN INDIA

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 "un-included" 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.

CASE STUDIES

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 crops - soyabean, coffee, wheat, rice, pulses, shrimp - in over 40,000 villages through 6500 kiosks across ten states (Madhya Pradesh, Haryana, Uttarakhand, Karnataka, Andhra Pradesh, Uttar Pradesh, Rajasthan, Maharashtra, Kerela and Tamil Nadu).

Before the enactment of the Companies Act, 2013, various other laws in India took care of the basic CSR included various legislations under labour laws such as Factories Act, 1948, ESI Act, 1948, Employees Compensation Act, 1923, Contract Labour (Regulation and Abolition) Act, 1970, Equal Remuneration Act, 1976, The Minimum Wages Act, 1948, Employees' Provident Fund and Miscellaneous Provisions Act, 1952, environment protection laws such as The Water (Prevention and Control of Pollution) Act, 1974, The Air (Prevention and Control of Pollution) Act, 1981 and the Environment Protection Act, 1986

The main object of the **Factories Act, 1948** is 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** provides 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** is 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, provides for the protection and improvement of the natural environment including forests, lakes, rivers and wild life and to have compassion for living creatures.

The Water (Prevention and Control of Pollution) Act was enacted in 1974 and the Air (Prevention and Control of Pollution) Act was passed by the Union of India in 1981.

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.

Corporate Social Responsibility Voluntary Guidelines, 2009

The Corporate Social Responsibility Voluntary Guidelines issued by the MCA in December 2009 was the first step towards mainstreaming the concept of Business Responsibilities. Through these Guidelines, the Ministry urged the business sector to adopt the principles contained in the Guidelines for responsible business practices. It was recommendatory initiative to underline that the business sector also needs to take the responsibility of exhibiting socially responsible business practices that ensures the distribution of wealth and well-being of the communities in which the business operates.

National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business – 2011

Keeping in view the feedback from stakeholders, review of 2009 Guidelines was undertaken by the Guidelines Drafting Committee (GDC) constituted by the Indian Institute of Corporate Affairs, resulting into the formulation of 2011 Guidelines entitled **"National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business"** to mainstream the subject of business responsibilities. The Guidelines were released by MCA on July 8, 2011.

These guidelines were formulated keeping in view the diverse sectors within which businesses operate, as well as the wide variety of business organizations that exist in India today – from the small and medium enterprises to large corporate organizations.

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 and the core elements

The principles and the core elements of each of the principles as recommended by the National Voluntary Guidelines are summarized below:

Principles	Core Elements
Principle 1: **Businesses should conduct and govern themselves with Ethics, Transparency and Accountability**	The principle recognizes that ethical conduct in all functions and processes is the cornerstone of responsible business. 1. Businesses should develop governance structures, procedures and practices that ensure ethical conduct at all levels; and promote the adoption of this principle across its value chain. Businesses should communicate transparently and assure access to information about their decisions that impact relevant stakeholders. 2. Businesses should not engage in practices that are abusive, corrupt, or anti-competition. 3. Businesses should truthfully discharge their responsibility on financial and other mandatory disclosures. 4. Businesses should report on the status of their adoption of these Guidelines as suggested in the reporting framework in NVG's. 5. Businesses should avoid complicity with the actions of any third party that violates any of the principles contained in these Guidelines
Principle 2: **Businesses should provide goods and services that are safe and contribute to sustainability throughout their life cycle**	The principle recognizes that all stages of the product life cycle, right from design to final disposal of the goods and services after use, have an impact on society and the environment. Responsible businesses, therefore, should engineer value in their goods and services by keeping in mind these impacts. 1. Businesses should assure safety and optimal resource use over the life-cycle of the product – from design to disposal – and ensure that everyone connected with it- designers, producers, value chain members, customers and recyclers are aware of their responsibilities.

	2. Businesses should raise the consumer's awareness of their rights through education, product labelling, appropriate and helpful marketing communication, full details of contents and composition and promotion of safe usage and disposal of their products and services. 3. In designing the product, businesses should ensure that the manufacturing processes and technologies required to produce it are resource efficient and sustainable. 4. Businesses should regularly review and improve upon the process of new technology development, deployment and commercialization, incorporating social, ethical, and environmental considerations. 5. Businesses should recognize and respect the rights of people who may be owners of traditional knowledge, and other forms of intellectual property. 6. Businesses should recognize that over-consumption results in unsustainable exploitation of our planet's resources, and should therefore promote sustainable consumption, including recycling of resources.
Principle 3: **Businesses should promote the well being of all employees**	The principle encompasses all policies and practices relating to the dignity and well being of employees engaged within a business or in its value chain. 1. Businesses should respect the right to freedom of association, participation, collective bargaining, and provide access to appropriate grievance redressal mechanisms. 2. Businesses should provide and maintain equal opportunities at the time of recruitment as well as during the course of employment irrespective of caste, creed, gender, race, religion, disability or sexual orientation. 3. Businesses should not use child labour, forced labour or any form of involuntary labour, paid or unpaid. 4. Businesses should take cognizance of the work-life balance of its employees, especially that of women. 5. Businesses should provide facilities for the well being of its employees including those with special needs. They should ensure timely payment of fair living wages to meet basic needs and economic security of the employees. 6. Businesses should provide a workplace environment that is safe, hygienic humane, and which upholds the dignity of the employees. Business should communicate this provision to their employees and train them on a regular basis. 7. Businesses should ensure continuous skill and competence upgrading of all employees by providing access to necessary learning opportunities, on an equal and non-discriminatory basis. They should promote employee morale and career development through enlightened human resource interventions. 8. Businesses should create systems and practices to ensure a harassment free workplace where employees feel safe and secure in discharging their responsibilities.

Principle 4: **Businesses should respect the interests of, and be responsive towards all stakeholders, especially those who are disadvantaged, vulnerable and marginalized.**	The principle recognizes that businesses have a responsibility to think and act beyond the interests of its shareholders to include all their stakeholders. 1. Businesses should systematically identify their stakeholders, understand their concerns, define purpose and scope of engagement, and commit to engaging with them. 2. Businesses should acknowledge, assume responsibility and be transparent about the impact of their policies, decisions, product & services and associated operations on the stakeholders. 3. Businesses should give special attention to stakeholders in areas that are underdeveloped. 4. Businesses should resolve differences with stakeholders in a just, fair and equitable manner.
Principle 5: **Businesses should respect and promote human rights**	The principle takes into account the "Corporate Responsibility to Respect Human Rights", as referred in the United Nations "Protect, Respect, Remedy" Framework. 1. Businesses should understand the human rights content of the Constitution of India, national laws and policies and the content of International Bill of Human Rights. Businesses should appreciate that human rights are inherent, universal, indivisible and interdependent in nature. 2. Businesses should integrate respect for human rights in management systems, in particular through assessing and managing human rights impacts of operations, and ensuring all individuals impacted by the business have access to grievance mechanisms. 3. Businesses should recognize and respect the human rights of all relevant stakeholders and groups within and beyond the workplace, including that of communities, consumers and vulnerable and marginalized groups. 4. Businesses should, within their sphere of influence, promote the awareness and realization of human rights across their value chain. 5. Businesses should not be complicit with human rights abuses by a third party.
Principle 6: **Business should respect, protect, and make efforts to restore the environment.**	The principle recognizes that environmental responsibility is a prerequisite for sustainable economic growth and for the well being of society. 1. Businesses should utilize natural and manmade resources in an optimal and responsible manner and ensure the sustainability of resources by reducing, reusing, recycling and managing waste. 2. Businesses should take measures to check and prevent pollution. They should assess the environmental damage and bear the cost of pollution abatement with due regard to public interest.

	3. Businesses should ensure that benefits arising out of access and commercialization of biological and other natural resources and associated traditional knowledge are shared equitably. 4. Businesses should continuously seek to improve their environmental performance by adopting cleaner production methods, promoting use of energy efficient and environment friendly technologies and use of renewable energy. 5. Businesses should develop Environment Management Systems (EMS) and contingency plans and processes that help them in preventing, mitigating and controlling environmental damages and disasters, which may be caused due to their operations or that of a member of its value chain. 6. Businesses should report their environmental performance, including the assessment of potential environmental risks associated with their operations, to the stakeholders in a fair and transparent manner. 7. Businesses should proactively persuade and support its value chain to adopt this principle.
Principle 7: **Businesses, when engaged in influencing public and regulatory policy, should do so in a responsible manner**	The principle recognizes that businesses operate within the specified legislative and policy frameworks prescribed by the Government, which guide their growth and also provide for certain desirable restrictions and boundaries. 1. Businesses, while pursuing policy advocacy, must ensure that their advocacy positions are consistent with the Principles and Core Elements contained in these Guidelines. 2. To the extent possible, businesses should utilize the trade and industry chambers and associations and other such collective platforms to undertake such policy advocacy.
Principle 8: Businesses should support inclusive growth and equitable development	The principle recognizes the value of the energy and enterprise of businesses and encourages them to innovate and contribute to the overall development of the country, especially to that of the disadvantaged, vulnerable and marginalised sections of society. 1. Businesses should understand their impact on social and economic development, and respond through appropriate action to minimise the negative impacts. 2. Businesses should innovate and invest in products, technologies and processes that promote the well being of society. 3. Businesses should make efforts to complement and support the development priorities at local and national levels, and assure appropriate resettlement and rehabilitation of communities who have been displaced owing to their business operations. 4. Businesses operating in regions that are underdeveloped should be especially sensitive to local concerns.

Principle 9: **Businesses should engage with and provide value to their customers and consumers in a responsible manner**	This principle is based on the fact that the basic aim of a business entity is to provide goods and services to its customers in a manner that creates value for both. 1. Businesses, while serving the needs of their customers, should take into account the overall well-being of the customers and that of society. 2. Businesses should ensure that they do not restrict the freedom of choice and free competition in any manner while designing, promoting and selling their products. 3. Businesses should disclose all information truthfully and factually, through labeling and other means, including the risks to the individual, to society and to the planet from the use of the products, so that the customers can exercise their freedom to consumer in a responsible manner. Where required, businesses should also educate their customers on the safe and responsible usage of their products and services. 4. Businesses should promote and advertise their products in ways that do not mislead or confuse the consumers or violate any of the principles in these Guidelines. 5. Businesses should exercise due care and caution while providing goods and services that result in over exploitation of natural resources or lead to excessive conspicuous consumption. 6. Businesses should provide adequate grievance handling mechanisms to address customer concerns and feedback.

The Companies Act, 2013

The Act brought the concept of Corporate Social Responsibility in India to the forefront. It aimed to promote greater transparency and disclosure. The Ministry of Corporate Affairs through Section 135 and Schedule VII of the Companies Act 2013 as well as the Companies (Corporate Social Responsibility Policy) Rules, 2014 mandated the provisions of the corporate social responsibility for certain classes of companies.

(The provisions have been covered in the previous chapters in this study material).

SEBI (LODR) Regulations, 2015

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, 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"). The key principles which are required to be reported by the entities pertain to areas such as environment, governance, stakeholder's relationships, etc.

National Guidelines on Responsible Business Conduct (NGRBC), 2019

In March 2019, the Ministry of Corporate Affairs has revised the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, 2011 (NVGs) and has released the **National Guidelines on Responsible Business Conduct (NGRBC)**. These guidelines urge businesses to actualise the principles in letter and spirit.

The MCA has been taking various initiatives for ensuring responsible business conduct by companies. As a first step towards mainstreaming the concept of business responsibility, the Voluntary Guidelines on Corporate Social Responsibility were issued in 2009. These guidelines were subsequently revised as National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business in 2011 after extensive consultations with business, academia, civil society organisations and the government. The NVGs were developed based on India's socio-cultural context and priorities as well as global best practices.

Since then, there have been various national and international developments in the past decade that have nudged businesses to be sustainable and more responsible. The Companies Act, 2013 also lays down the thrust for businesses to be more mindful of their stakeholders. The Companies Act, 2013 casts fiduciary duties on the Directors of a Company requiring them 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.

The NGBRC provides that businesses should conduct and govern themselves with integrity in a manner that is ethical, transparent and accountable. Businesses should provide goods and services in a manner that is sustainable and safe. It should also respect and promote the well-being of all employees, including those in their value chains and the interests of all their stakeholders; and the businesses should respect and promote human rights.

The NGRBC are designed to be used by all businesses, irrespective of their ownership, size, sector, structure or location. It is expected that all businesses investing or operating in India, including foreign multinational corporations (MNCs) should follow these guidelines. Correspondingly, the NGRBC also provide a useful framework for guiding Indian MNCs in their overseas operations, in addition to aligning with applicable local national standards and norms governing responsible business conduct. Furthermore, the NGRBC reiterate the need to encourage businesses to ensure that not only do they follow these guidelines in business contexts directly within their control or influence, but that they also encourage and support their suppliers, vendors, distributors, partners and other collaborators to follow them.

The nine thematic pillars of business responsibility provided by the NGBRC are:

Businesses should conduct and govern themselves with integrity in a manner that is Ethical, Transparent and Accountable.	Businesses should provide goods and services in a manner that is sustainable and safe	Businesses should respect and promote the well-being of all employees, including those in their value chains.
Businesses should respect the interests of and be responsive to all their stakeholders.	Businesses should respect and promote human rights.	Businesses should respect and make efforts to protect and restore the environment.
Businesses, when engaging in influencing public and regulatory policy, should do so in a manner that is responsible and transparent.	Businesses should promote inclusive growth and equitable development.	Businesses should engage with and provide value to their consumers in a responsible manner.

Principle 1: Businesses should conduct and govern themselves with integrity in a manner that is Ethical, Transparent and Accountable:

This Principle recognizes that ethical behaviour in all operations, functions and processes, is the cornerstone of businesses guiding their governance of economic, social and environmental responsibilities. It recognizes that businesses are an integral part of society and that they will hold themselves accountable for the effective adoption, implementation, and the making of disclosures on their performance with respect to the Core Elements of these Guidelines.

Principle 2: Businesses should provide goods and services in a manner that is sustainable and safe:

This Principle recognizes that sustainable production and consumption are inter-related and contribute to enhancing the quality of life and towards protecting and preserving earth's natural resources. The Principle further emphasizes that businesses should focus on safety and resource-efficiency in the design and manufacture of their products, and uses their products in a manner that creates value while minimizing and mitigating its adverse impacts on the environment and society through all stages of its life cycle, from design to final disposal. In order to do so, the Principle encourages businesses to understand all material sustainability issues across their product life cycle and value chain.

Principle 3: Businesses should respect and promote the well-being of all employees, including those in their value chains:

This Principle encompasses all policies and practices relating to the equity, dignity and well-being, and provision of decent work of all employees engaged within a business or in its value chain, without any discrimination and in a way that promotes diversity. The principle recognizes that the well-being of an employee also includes the wellbeing of her/his family.

Principle 4: Businesses should respect the interests of and be responsive to all their stakeholders:

This Principle recognizes that businesses operate in an eco-system comprising of various stakeholders and that their activities impact natural resources, habitats, communities and the environment. The Principle acknowledges that it is the responsibility of businesses to ensure that the interests of all stakeholders, especially those who may be vulnerable and marginalized, are protected. The Principle further recognizes that businesses have a responsibility to maximize the positive impacts and minimize and mitigate the adverse impacts of its products, operations, and practices on all their stakeholders.

Principle 5: Businesses should respect and promote human rights:

This Principle recognizes that human rights are rights inherent to all human beings, and that everyone, individually or collectively, is entitled to these rights, without discrimination. The Principle is inspired, informed and guided by the Constitution of India and the International Bill of Rights and recognizes the primacy of the State's duty to protect and fulfil human rights. It affirms that the responsibility of businesses to respect human rights requires that it avoids causing or contributing to adverse human rights impacts, and that it addresses such impacts when they occur. The Principle urges businesses to be especially responsive to such persons, individually or collectively, who are most vulnerable to, or at risk of, such adverse human rights impacts.

Principle 6: Businesses should respect and make efforts to protect and restore the environment:

This Principle recognizes that environmental responsibility is a prerequisite for sustainable economic growth and for the well-being of society. The Principle emphasizes that environmental issues are interconnected at the local, regional and global levels, which makes it imperative for businesses to address issues like pollution, biodiversity conservation, sustainable use of natural resources and climate change in a just, comprehensive and systematic manner. The Principle encourages businesses to adopt environmental practices and processes that minimize or eliminate the adverse impacts of its operations and across the value chain. The Principle encourages businesses to follow the Precautionary Principle in all its actions.

Principle 7: Businesses, when engaging in influencing public and regulatory policy, should do so in a manner that is responsible and transparent:

This Principle recognizes that businesses operate within specified national and international legislative and policy frameworks, which guide their growth and also provide for certain desirable restrictions and boundaries. The Principle recognizes the legitimacy of businesses to engage with governments for redressal of a grievance or for influencing public policy.

Principle 8: Businesses should promote inclusive growth and equitable development:

This Principle recognizes the challenges of social and economic development faced by India, and builds upon the national and local development agenda as articulated in government policies and priorities. This is particularly significant in zones affected by social disharmony and low human development. The encourages them to innovate and contribute to the overall development of the country with a specific focus on disadvantaged, vulnerable and marginalized communities, as articulated in Section 135 of the Companies Act, 2013. The Principle also emphasizes the need for collaboration amongst businesses, government agencies and civil society in furthering this development. The Principle reiterates that business success, inclusive growth and equitable development are interdependent.

Principle 9: Businesses should engage with and provide value to their consumers in a responsible manner:

This Principle is based on the fact that the basic aim of a business entity is to provide goods and services to its consumers that are safe to use, and in a manner that creates value for both. . The Principle recognizes that consumers have the freedom of choice in the selection and usage of goods and services, and that the enterprises will strive to make available products that are safe, competitively priced, easy to use and safe to dispose of, for the benefit of their consumers. The Principle also recognizes that businesses should play a key role, in mitigating the adverse impacts that excessive consumption of its products may have on the overall well-being of individuals, society and our planet.

More recently, the businesses are increasingly recognizing that responsible business conduct provides benefits to both the business and society in the short term as well as in the long term. The obligation of businesses to conduct themselves responsibly is an essential component of the social contract between businesses and society. These Guidelines are another initiative by the MCA to ensure that the business conduct themselves in socially and economically responsible manner.

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 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.

Environmentalists claim that living things other than humans, and the natural environment as a whole, deserve consideration in reasoning about the morality of political, economic, and social policies. The movement seeks to improve and protect the quality of the natural environment through bringing about changes in environmentally harmful human activities; adoption of forms of political, economic, and social organization that are thought to be necessary for, or at least conducive to, the benign treatment of the environment by humans; and a reassessment of humanity's relationship with nature.

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.

Some of the major treaties on environmental and social aspects are discussed below-

1. United Nations Conference on Human Environment

The United Nations Conference on the Human Environment (also known as the Stockholm Conference) was an international conference convened under United Nations auspices held in Stockholm, Sweden from June 5-16,1972. It was the UN's first major conference on international environmental issues, and marked a turning point in the development of international environmental politics. One of the key issues addressed was the use of CFCs (chlorofluorocarbons) which were thought to be responsible for the depletion of the ozone layer. The Stockholm Conference laid a framework for future environmental cooperation; led to the creation of global and regional environmental monitoring networks and the creation of the United Nations Environment Programme.

2. United Nations Environment Programme

United Nations Environment Programme (UNEP), established in 1972, is the voice for the environment within the United Nations system. UNEP acts as a catalyst, advocate, educator and facilitator to promote the wise use and sustainable development of the global environment. To accomplish this, UNEP works with a wide range of partners, including United Nations agencies, international organizations, national governments, non-

governmental organizations, the private sector and civil society. The Mission of the United Nation's Environment Programme is -

"To provide leadership and encourage partnership in caring for the environment by inspiring, informing, and enabling nations and peoples to improve their quality of life without compromising that of future generations."

The major Milestones of the UNEP include:

- 1973 - Convention on International Trade in Endangered Species (CITES)
- 1985 - Vienna Convention for the Protection of the Ozone Layer
- 1987 - Montreal Protocol on Substances that Deplete the Ozone Layer
- 1988 - Intergovernmental Panel on Climate Change (IPCC)
- 1989 - Basel Convention on the Transboundary Movement of Hazardous Wastes
- 1992 - UN Conference on Environment and Development (Earth Summit) publishes Agenda 21, a blueprint for sustainable development
- 1992 - Convention on Biological Diversity
- 2000 - Malmö Declaration - first Global Ministerial Forum on the Environment calls for strengthened international environmental governance
- 2000 - Millennium Declaration - environmental sustainability was included as one of eight Millennium Development Goals
- 2002 - World Summit on Sustainable Development
- 2004 - Bali Strategic Plan for Technology Support and Capacity Building
- 2005 - World Summit outcome document highlights key role of environment in sustainable development
- 2012 - The United Nations Conference on Sustainable Development (Rio +20)
- 2013-15 – High level Political Forum on Sustainable Development
- 2015 – United Nations Sustainable Development Summit, 2015 (New York)

In India, the Water (Prevention and Control of Pollution) Act, 1974 and the Air (Prevention and Control of Pollution) Act, 1981 have been enacted, essentially to give effect to the decisions taken at the International Conference on Human Environment at Stockholm in 1972 declaring man's fundamental right to live in a pollution-free atmosphere and his responsibility to protect and improve the environment.

Millennium Development Goals (MDGs)

The Millennium Development Goals (MDGs) were eight international development goals that were officially established following the Millennium Summit of the United Nations in 2000, following the adoption of the United Nations Millennium Declaration. All 189 United Nations member states agreed to achieve these goals by the year 2015. The goals were:

1. Eradicating extreme poverty and hunger,
2. Achieving universal primary education,
3. Promoting gender equality and empowering women,
4. Reducing child mortality rates,
5. Improving maternal health,

6. Combating HIV/AIDS, malaria, and other diseases,
7. Ensuring environmental sustainability, and
8. Developing a global partnership for development.

3. Brundtland Commission

The Brundtland Commission, formally the World Commission on Environment and Development (WCED), known by the name of its Chairman Gro Harlem Brundtland, was convened by the United Nations in 1983. The Commission was created to address growing concern "about the accelerating deterioration of the human environment and natural resources and the consequences of that deterioration for economic and social development." In establishing the Commission, the UN General Assembly recognized that environmental problems were global in nature and determined that it was in the common interest of all nations to establish policies for sustainable development.

The Report of the Brundtland Commission, Our Common Future, published in 1987, deals with sustainable development and the change of policies needed for achieving that. The definition of this term in the report is quite well known and often cited:

"Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs."

4. United Nations Conference on Environment and Development

The United Nations Commission on Sustainable Development (CSD) was established by the UN General Assembly in December 1992 to ensure effective follow-up of United Nations Conference on Environment and Development (UNCED) (known as the Earth Summit) held in Rio De Janeiro. The following documents were the outcome of the Rio Summit:

- *Agenda 21* – is a blueprint on how to make development socially, economically and environmentally sustainable.
- *The Rio Declaration on Environment and Development* – it has 27 principles defining the rights and responsibilities of nations as they pursue human development and well-being.
- *A statement of forest principles* – they guide the management, conservation and sustainable development of all types of forests, as essential to economic development and the maintenance of all forms of life.
- *The United Nations Framework Convention on Climate Change* – aims to stabilize greenhouse gas concentrations in the atmosphere at levels that would prevent dangerous human induced interference with the climate system.
- *The Convention on Biological Diversity* – it requires the countries to adopt ways and means to conserve the variety of living species, and ensure that the benefits from using biological diversity are equitably shared.
- *Montreal Protocol on Substances that Deplete the Ozone Layer* was designed to reduce the production and consumption of ozone depleting substances.

5. Kyoto Protocol

The Kyoto Protocol, adopted at the third Conference of the Parties to the UNFCCC (COP 3) in Kyoto, Japan, in 1997 came into force in 2005, is an international agreement linked to the United Nations Framework Convention on Climate Change. The major feature of the Kyoto Protocol is that it sets binding targets for 37 industrialized countries and the European community for reducing greenhouse gas (GHG) emissions. This amount to an average of five per cent against 1990 levels over the five-year period 2008-2012.

The major distinction between the Protocol and the Convention is that while the Convention encouraged industrialised countries to stabilize GHG emissions, the Protocol commits them to do so.

The Protocol requires developed countries to reduce their GHG emissions below the levels specified for each of them in the Treaty. These targets must be met within a five-year time frame between 2008 and 2012, and add up to a total cut inGHG emissions of at least 5% against the baseline of 1990.

The Protocol places a heavier burden on developed nations under the principle of "common but differentiated responsibilities." This has two main reasons. Firstly, those countries can more easily pay the cost of cutting emissions. Secondly, developed countries have historically contributed more to the problem by emitting larger amounts ofGHGs per person than the developing countries.

In order to give parties a certain degree of flexibility in meeting their emission reduction targets, the Protocol developed three innovative mechanisms - known as Emissions Trading (the carbon market), Joint Implementation and the Clean Development Mechanism (CDM).

These market-based mechanisms allow developed parties to earn and trade emissions credits through projects implemented either in other developed countries or in developing countries, which theycan use towards meeting their commitments. These mechanisms help identify lowest-cost opportunities forreducing emissionsand attract private sector participation in emission reduction efforts. Developing nations benefit in terms of technology transfer and investment brought about through collaboration with industrialized nations under the CDM.

The Kyoto Protocol is generally seen as an important first step towards a truly global emission reduction regime that will stabilize GHG concentrations at a level which will avoid dangerous climate change. As a result of the Protocol, governments have already put, and are continuing to put legislation and policies in place to meet their commitments; a carbon market has been created; and more and more businesses are making the investment decisions needed for a climate-friendly future. The Protocol provides the essential architecture for any new international agreement or set of agreements on climate change. The first commitment period of the Kyoto Protocol expired in 2012.

The targets cover emissions of the six main greenhouse gases, namely:

- Carbon dioxide (CO2);
- Methane (CH4);
- Nitrous oxide (N2O);
- Hydrofluorocarbons (HFCs);
- Perfluorocarbons (PFCs); and
- Sulphur hexafluoride (SF6)

The detailed rules for the implementation of the Protocol were adopted at COP 7 in Marrakesh in 2001, and are called the "Marrakesh Accords."

6. Bali Roadmap

At the 2007 United Nations Climate Change Conference in Bali, Indonesia in December, 2007, the participating nations adopted the Bali Roadmap as a two-year process for finalizing a bindinig agreement in 2009 in Denmark.

The Bali Road Map consists of a number of forward-looking decisions that represent the various tracks essential to reaching a secure climate future. The Bali Road Map includes the Bali Action Plan, which charts the course for a new negotiating process designed to tackle climate change, with the aim of completing this by 2009. To conduct the process, a subsidiary body under the Convention called the Ad Hoc Working Group on Long-term Cooperative Action under the Convention (AWG-LCA) was set up.

To discuss future commitments for industrialized countries under the Kyoto Protocol, the Conference of the Parties serving as the Meeting of the Parties to the Kyoto Protocol established a working group in December 2005, called the Ad Hoc Working Group on further Commitments for Annex I Parties under the Kyoto Protocol (AWG-KP).

7. United Nations Conference on Sustainable Development, Rio+20

The United Nations Conference on Sustainable Development - or Rio+20 - took place in Rio de Janeiro, Brazil on 20-22 June 2012. It resulted in a focused political outcome document **which contains clear and practical measures for implementing sustainable development.**

In Rio, Member States decided to launch a process to develop a set of Sustainable Development Goals (SDGs), which will build upon the Millennium Development Goals **and converge with the post 2015 development agenda.**

The Conference also adopted ground-breaking guidelines on green economy policies. Governments also decided to establish an intergovernmental process under the General Assembly to prepare options on a strategy for sustainable development financing. The Rio+20 outcome document "The Future We Want" resolved to establish an inclusive and transparent intergovernmental process on SDGs that is open to all stakeholders with a view to develop global sustainable development goals agreed by the UN General Assembly.

Following are some commitments adopted under Rio+20 outcome document:

1. **Poverty Eradication:** poverty eradication should be given highest priority within UN agenda;
2. **Food Security and Nutrition and Sustainable Agriculture:** commitment of the right of everyone to have access to safe, sufficient and nutritious food, importance of sustainable agriculture and recognition to the importance of addressing the access of rural communities to credit, financial services, markets, land tenure, health care and social services;
3. **Energy:** critical role of energy in sustainable development – access to sustainable modern energy contributes to poverty eradication, saves lives and improves health, essential to social inclusion and gender equality.
4. **Sustainable transport:** importance of environmentally sound, safe and affordable transportation as a means to improve social equity and health. Support development of sustainable transport systems, notably public mass transportation systems. Acknowledge that developing countries need assistance.
5. **Sustainable cities:** well planned and integrated cities can be economically, socially and environmentally sustainable - including housing, safe and healthy living environment for all, particularly the vulnerable; affordable and sustainable transport and energy, promotion and protection of safe and green urban spaces, water and sanitation, air quality, decent jobs and improved urban planning and slum upgrading. Recognize importance of mixed-use planning and non-motorized mobility - including by promoting pedestrian and cycling infrastructures.
6. **Health and population**: Health is a precondition for an outcome of and an indicator of all three dimensions of sustainable development. Sustainable development cannot be achieved in the presence of high burden on communicable/non communicable diseases.
7. Commit to strengthen health systems toward the provision of equitable, universal coverage and promote **affordable access to prevention, treatment, care and support related to NCDs,** especially cancer, cardiovascular diseases, chronic respiratory diseases and **diabetes**.
8. Commit to establish or strengthen **multi-sectoral national policies** for the prevention and control of non-communicable diseases.
9. Reaffirm the full right to use TRIPS provisions and Doha Declaration on TRIPs to **promote access to**

medicines for all and encourage development assistance in this regard.

10. Call to **strengthen health systems** through increased financing and the **recruitment/training/retention of health workers,** improved distribution and access to medicines and improving health infrastructure.
11. Commit and consider population trends in development policy, emphasize need for **universal access to reproductive health,** including family planning and protection of human rights in this context
12. Commit to reducing maternal and child mortality, gender equality and protection of human rights on matters related to sexuality, and work to ensure health systems, address sexual and reproductive health.
13. **Promoting full and productive employment, decent work for all, and social protections:** need to provide productive employment and decent work for all. Recognize importance of job creation. Workers should have access to education, skills and healthcare, including occupational health and safety.

8. Paris Agreement on Climate Change, 2015

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.

THE 2030 AGENDA FOR SUSTAINABLE DEVELOPMENT

The 2030 agenda for Sustainable Development is a plan of action for people, planet and prosperity. It also seeks to strengthen universal peace in larger freedom. The 17 Sustainable Development Goals and 169 targets demonstrate the scale and ambition of this new universal Agenda. They seek to build on the Millennium Development Goals and complete what these did not achieve. They seek to realize the human rights of all and to achieve gender equality and the empowerment of all women and girls. They are integrated and indivisible and balance the three dimensions of sustainable development: the economic, social and environmental. The Goals and targets will stimulate action over the next fifteen years in areas of critical importance for humanity and the planet.

Sustainable Development Goals

1. Goal 1. End poverty in all its forms everywhere
2. Goal 2. End hunger, achieve food security and improved nutrition and promote sustainable agriculture
3. Goal 3. Ensure healthy lives and promote well-being for all at all ages
4. Goal 4. Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all
5. Goal 5. Achieve gender equality and empower all women and girls
6. Goal 6. Ensure availability and sustainable management of water and sanitation for all
7. Goal 7. Ensure access to affordable, reliable, sustainable and modern energy for all

8. Goal 8. Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all
9. Goal 9. Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation
10. Goal 10. Reduce inequality within and among countries
11. Goal 11. Make cities and human settlements inclusive, safe, resilient and sustainable
12. Goal 12. Ensure sustainable consumption and production patterns
13. Goal 13. Take urgent action to combat climate change and its impacts*
14. Goal 14. Conserve and sustainably use the oceans, seas and marine resources for sustainable development
15. Goal 15. Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss
16. Goal 16. Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels
17. Goal 17. Strengthen the means of implementation and revitalize the global partnership for sustainable development

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.

MEASURING BUSINESS SUSTAINABILITY

Some approaches to measure business sustainability are discussed below.

ALTMAN Z-SCORE

The Altman Z Score model is a financial model to predict the likelihood of bankruptcy in a company. It was created by Edward I. Altman, a professor at the Leonard N. Stern School of Business of New York University. His aim at predicting bankruptcy began around the time of the great depression, in response to a sharp rise in the incidence of default. 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 purpose of the Z Score Model is to measure a company's financial health and to predict the probability that a company will collapse within 2 years. It is proven to be very accurate to forecast bankruptcy in a wide variety of contexts and markets. Studies show that the model has 72% – 80% reliability of predicting bankruptcy. However, the Z-Score does not apply to every situation. It can only be used for forecasting if a company being analyzed can be compared to the database.

The Z-score uses multiple corporate income and balance sheet values to measure the financial health of a company. The Z-score is a linear combination of five common business ratios, weighted by coefficients.

Formula

Z-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.

- D = market value of equity / 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 = sales / 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.

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.

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.

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-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.

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. 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 net operating profit after tax less capital charge.

Or, EVA = NOPAT- (Invested Capital × 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 (ROA = operating income / capital), which compares operating income to capital employed in a multiplicative operation.

EVA assesses the performance of a company and its management through the idea that a business is only profitable when it creates wealth and returns for shareholders, thus requiring performance above a company's cost of capital. EVA as a performance indicator is very useful. The calculation shows how and where a company created wealth, through the inclusion of balance sheet items. This forces managers to be aware of assets and expenses when making managerial decisions. However, the EVA calculation relies heavily on the amount of invested capital, and is best used for asset-rich companies that are stable or mature. Companies with intangible assets, such as technology businesses, may not be good for an EVA evaluation.

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 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.

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. 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 EVAs a Company is expected to generate, discounted at the WACC.

Market Value Added (MVA) = PV (EVA)

Theoretically, MVA is equal to the present value of all future EVAs.

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.

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.

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

- 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 Sustainibilty: 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.
- The Altman Z Score model is a financial model to predict the likelihood of bankruptcy in a company.

LESSON ROUND-UP

- 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.
- 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 (corporate sustainability) is derived from the concept of sustainable development which is defined by the Brundt land Commission as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs”.
- Corporate citizenship is a commitment to improve community well-being through voluntary business practices and contribution of corporate resources leading to sustainable growth.
- 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.
- 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 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.
- 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, 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”).
- In March 2019, the Ministry of Corporate Affairs has revised the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, 2011 (NVGs) and has released the National Guidelines on Responsible Business Conduct (NGRBC), 2019.

– 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.

SELF-TEST QUESTIONS

(*These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation*)

1. Explain Corporate Social Responsibility. Why is CSr important?
2. What is Sustainability Reporting?
3. Write a short note on the principles of UN Global Compact.
4. Describe the principles under National Guidelines on Responsible Business Conduct (NGRBC), 2019
5. Explain sustainable development and goals of sustainable development.
6. Write a short note on EVA and MVA.

Lesson 18

Anti-Corruption and Anti-Bribery Laws in India

LESSON OUTLINE

- Introduction
- Bribery and Corruption - Global Scenarios
- Brief Information on the Laws and Enforcement Regime in India
- Delhi Special Police Establishment Act, 1946
- Unlawful Activities (Prevention) Act, 1967
- Foreign Corrupt Practices Act, 1977 (The Fcpa)
- Prevention Of Corruption Act, 1988 (The PCA)
- Central Vigilance Commission Act, 2003
- Lokpal And Lokayukta Act, 2013 (The LLA)
- ICSI Anti Bribery Code
- 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 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.

"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 aboard). 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).

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 Assenton 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.

BRIEF INFORMATION ON THE LAWS AND ENFORCEMENT REGIME IN INDIA

(A) 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 2 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 the members of the said force in regard to the investigation of the said offences.

(B) UNLAWFUL ACTIVITIES (PREVENTION) ACT, 1967

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 became 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.

(C) 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.

(D) 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 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.

(E) 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.

The Act amended the Delhi Special Police Establishment Act, 1946. The Government of India in the Ministry 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.

(F) 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.

(G) 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 t he Corporate Anti- Bribery Code.

The disciplinary mechanism shall include:

- Nature of offence
- Penalty of the office
- 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 entirely 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]

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.
- Facilitaion 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

(*These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation*)

1. Enumerate the laws and enforcement regimes behind Anti-Corruption and Anti-Bribery Laws in India.
2. Brief description of the Prevention of Corruption, 1988.
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?
6. Liability of individual directors and officers under Prevention of Corruption Act, 1988.
7. Define the following terms;
   - Bribery
   - Facilitation payment
   - Foreign public official

PROFESSIONAL PROGRAMME

GOVERNANCE, RISK MANAGEMENT, COMPLIANCES AND ETHICS

PP-GRMCE

TEST PAPER

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 OECD Principles have each played a major role in the development of corporate governance codes around the world. ***(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. Being a Company Secretary you were requested to give your views on such removal of chairman.

(5 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)***

(d) Discuss why it is considered a good practice to separate the role of Chairman and CEO in a company. ***(5 marks)***

Attempt 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 and functions 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) CSR Policy

(b) Rotation of Auditors

(c) Website Disclosures under SEBI (LODR) Regulations, 2015

(d) Class Action Suit

(e) The Clarkson Principles of Stakeholder Management

(3 marks each)

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? (5 marks each)

PART - II

Attempt all parts of either Question No. 4 or Question No. 4A

4. (a) "Risk is inherent in every business, whether it is of financial nature or non-financial nature." Explain in brief the risk management process for a company.

(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. ***(5 marks each)***

Or (Alternate question to Q. No. 4)

4A. Discuss in brief the following:

(a) Enterprise Risk Management

(b) Risk Governance

(c) Reputation Risk Management

(d) ISO 31000 ***(5 marks each)***

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.

(b) Discuss the Internal Compliance Reporting Mechanism (ICRM).

(c) Write a brief note on COSO's Internal Control Framework

(d) Discuss the scope and limitations of financial reporting ***(5 marks each)***

OR (Alternate question to Q. No. 5)

5A. (a) Discuss the role of Company Secretaries in Compliance Management.

(b) Write a note on the roles and responsibilities of Internal Control System.

(c) 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.

(d) 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.

(5 marks each)

PART - IV

Attempt all parts of either Question No.6 or Question No. 6A

6. (a) Explain the concept of CSR and why companies should adopt CSR in its strategy of growth?

   (b) Write a note on context and relevance of business ethics. ***(5 marks each)***

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)***